Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Calculating your adjusted cost base

Determining your capital gain or loss

The adjusted cost base (ACB) of a property is used to determine the capital gain or loss for Canadian tax purposes. As such, you need to keep track of and report the ACB of each property you have disposed of on your tax return. This article discusses how to calculate the ACB with respect to different types of investments and some common events that may affect ACB calculations.

It's important to note that while you may have information about the ACB of your investments on your statements, there are numerous events that can impact the ACB for tax purposes that may not be reflected. With this in mind, it's essential to seek advice from a qualified tax advisor when determining the ACB of your investments.

Additionally, note that, when you sell property, the sale may be a capital or an income transaction for tax purposes. The type of transaction depends on the nature of the property and the manner in which you deal with it. For most investors, the sale of stocks, bonds and other financial products will likely be considered a capital transaction. This article looks at those sales that are considered capital in nature only. If you're unsure if a sale is capital or income in nature, you should seek the guidance of a qualified tax advisor.

Calculating your capital gain or loss

To appreciate why the ACB of an investment is important, you need to understand how capital gains and capital losses are calculated for tax purposes and the role ACB plays in this.

A capital gain or loss is calculated as follows:

Capital gain (or capital loss) = POD – Fees – ACB

Where:

POD = Proceeds of disposition

Fees = Brokerage fees and other outlays incurred to sell the property ACB = Adjusted cost base

If the result of the calculation is a positive number, you have a capital gain.

One-half of the gain is called a "taxable capital gain." If the result is negative, then you have a loss. One-half of the loss is called an "allowable capital loss."

You will need to subtract your allowable capital losses from your taxable capital gains in the tax year in which they occur. If your allowable capital losses are more than your taxable capital gains, the difference between the two becomes your net capital loss for the year. A net capital loss in a tax year may be carried back and applied against taxable capital gains reported in the past three years, or may be carried forward to any future year and to reduce future taxable capital gains. If your taxable capital gains are greater than your allowable capital losses, the difference is taxable to you for the year.

Determining ACB

The Canada Revenue Agency (CRA) guide on capital gains describes ACB as follows:

"Usually the cost of a property plus any expenses to acquire it, such as commissions and legal fees. The cost of a capital property is its actual or deemed cost, depending on the type of property and how you acquired it."

After using this as the initial starting point to determine the ACB, you would then factor in any purchases and sales, including corporate events like stock splits and reorganizations that may affect the ACB of the security. (Some common corporate events and their impact on ACB are discussed later on in this article.) Further, the investment type may also impact how the ACB is calculated.

In addition, there are some unique historical tax events that can impact the calculation of the ACB of any security. These events relate to certain dates where the taxation of capital gains and losses changed. (These, and their effect on ACB, are outlined in the appendix to this article.)

ACB and identical properties — the weighted-average cost method

The weighted-average cost method will generally need to be used to determine the ACB per share or unit of all identical properties held in an individual's non-registered accounts. Some of the common examples of identical properties are shares of the same class of the capital stock of a corporation or units of a particular mutual fund trust.

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Under this method, the ACB is calculated by dividing the total cost of a particular identical property by the total number of identical properties owned. Therefore, you must consider all identical properties in your different non-registered accounts, whether they are held at full-service brokerage firms, discount brokerage firms or in certificate form. For example, where you hold the shares of a particular corporation at RBC and the shares of the same corporation at another financial institution, the weighted-average cost would be applied to the identical shares held at the different institutions as a whole.

Below is an example of how ACB is calculated for buys and sells of an identical property:

- You purchase 100 shares of corporation X for $1,000 on March 1 (ACB of $10 per share.)
- In June of the same tax year, you purchase an additional 100 shares of corporation X for $2,000. After this purchase, you have 200 shares of corporation X with a total ACB of $3,000 ($1,000 + $2,000). On a per-unit basis, the ACB would be $3,000 total cost divided by the total number of shares of corporation X owned (200), which results in a weighted-average cost of $15 per share of corporation X.
- In November, you sell 50 shares of corporation X for proceeds of $5,000. This is after the June purchase, so you need to use your ACB of $15 per share to calculate the ACB of the 50 shares sold ($15 x 50 = $750). This results in a realized capital gain of $4,250.
- In December, you decide to purchase 60 more shares of corporation X for $7,000. After this transaction, you have 210 shares of corporation X (100 purchased in March, plus 100 purchased in June, less 50 sold in November, plus 60 purchased in December). The total ACB would be calculated as $3,000 (March and June purchases) less $750 (November sale) plus $7,000 (December purchase), which equals $9,250. The ACB per share would be $44.05 by taking the total ACB of $9,250 divided by the 210 shares owned.

The example is summarized in the below table:

Settlement date	Buy or sell	# shares	# shares remaining	Purchase price	Sale price	Total ACB	ACB per share
March	Buy	100	100	$1,000		$1,000	$10
June	Buy	100	200	$2,000		$3,000	$15
November	Sell	-50	150		$5,000	$2,250	$15
December	Buy	60	210	$7,000		$9,250	$44

If you're uncertain whether an investment is considered an identical property, it's important to seek advice from your qualified tax advisor.

Items that may impact ACB

The ACB of your investments can also be impacted by the investment structure, corporate reorganizations and events, and certain special transactions.

Types of investments

The ACB of an investment may be calculated differently based on the type of investment held by the taxpayer. For example, the ACB of both trust units and partnership units are calculated differently from regular stocks.

Trust units

In some instances, trust structured investments, commonly mutual funds and ETFs, may distribute out return of capital to their unitholders. Return of capital distributions are not taxable when received but will reduce the ACB of the security. As such, it's essential to track any return of capital and factor the distributions into the overall ACB of the investment.

If the ACB of the trust units is reduced to below zero during the taxation year through return of capital distributions, the negative amount is deemed to be a capital gain in the year, and the ACB of the trust units is deemed to be zero.

Partnership units

The calculation of the ACB of partnership units is a more involved calculation. It includes, among other items, the original amount paid to acquire the units, plus:

- Your share of income (including realized net capital gains) from all previous periods, not including the current period;
- Additional capital you contributed; and
- Any negative ACB amount previously or currently included in your taxable income if you're a limited partner;

Less:

- Your share of losses (including realized net capital losses) from all previous periods, not including the current period; and
- Distributions made by the partnership and any withdrawals you make (including return of capital).

The amounts reported on the T5013 for a year that you can use as a deduction or tax credit must be subtracted from the ACB at the beginning of the following year. Similarly, the amounts reported on the T5013 that you must report as income must be added to the ACB at the beginning of the following year, while losses are deducted from ACB.

If you're a Quebec taxpayer and if the partnership operates in Quebec and produces a Relevé 15 with figures that are different from the T5013 figures (e.g., if the business income for Quebec purposes is different from the business income for federal purposes), you'll have an ACB adjustment for Quebec tax purposes that differs from your ACB adjustment for federal tax purposes.

The treatment for flow-through limited partnerships is no different in that any amounts you report as a deduction must be subtracted from the ACB of your investment. Flow-through limited partnership amounts will be reported to you on the T5013. Flow-through shares are treated differently, as they're deemed to have an ACB of zero immediately after they're purchased. For more information on flow-through investments, please ask an RBC advisor for a separate article on this topic.

Taxpayer transactions and residency

There are certain transactions a taxpayer may initiate or be a recipient of that may impact ACB; these include superficial losses and non-arm's length transactions. Further, where a taxpayer becomes a Canadian resident for tax purposes, there's usually an impact on their ACBs.

It's important to be mindful of the impact of these events when calculating your ACB for a specific investment.

Superficial losses

A superficial loss will occur when a security is sold for a loss and both of the following occur:

1. You acquire or reacquire the identical security during the period beginning 30 days before the disposition and ending 30 days after the disposition of the original security; and

2. At the end of the above period, you still hold the identical security.

Among other situations, the superficial loss rules also apply if you sell an investment at a loss and it's acquired by your spouse or a corporation controlled by you and/or your spouse or a trust of which either you or your spouse is a majority interest beneficiary during the time period described earlier.

When a security is subject to the superficial loss rules, you will not be able to claim the capital loss you realize on the disposition. The denied loss is added back to the ACB of the security held.

Non-arm's length transactions – transactions between related persons

Non-arm's length transactions often impact tax treatment. Those who are related are generally considered to transact on a non-arm's length basis. Generally, related persons include individuals connected by blood relationship, marriage, common- law partnership or adoption. It's also possible for corporations and persons to be related for tax purposes. The following are some common examples in the context of capital gains and losses.

- If you purchase property from a non-arm's length party for an amount greater than fair market value (FMV), the cost of the property will be deemed to be equal to FMV regardless of the price you paid. This means the ACB of the property you acquired will be equal to the FMV at the time of acquisition rather than the actual amount you paid.

- On the other hand, if you were to pay an amount less than FMV for a property from a non-arm's length party, the ACB of the property will remain equal to the amount you paid. However, the seller will be deemed to have received proceeds equal to the FMV of the property and must use the higher amount to calculate their capital gain or loss for tax purposes.

For more information on related party transactions, speak with a qualified tax advisor.

> When you become a resident of Canada for tax purposes, there's an impact on the ACB of your assets. The securities owned prior to becoming a Canadian resident are generally deemed to be disposed of and reacquired at an ACB equal to the FMV of the property immediately before becoming a resident.

Becoming a Canadian resident

When you become a resident of Canada for tax purposes, there's an impact on the ACB of your assets. The securities owned prior to becoming a Canadian resident are generally deemed to be disposed of and reacquired at an ACB equal to the FMV of the property immediately before becoming a resident. This means that gains or losses accrued on the securities prior to Canadian residency will not be taxed in Canada.

Corporate events and reorganizations

Sometimes, the corporation you hold shares of may undergo an event that has an impact on the ACB of the shares you hold. The following sections describe some common events that may impact the ACB of your investment. You may also own other types of investments, such as trust or partnership units that may enter into transactions that may have an effect on your ACB. These transactions are beyond the scope of this article.

Stock splits

Where a corporation declares a stock split, generally their outstanding shares are split up into a greater number of shares. This type of transaction typically does not impact the total market value of the particular corporation, nor does it impact the overall ACB of your investment. However, the stock split does increase the number of shares you own, which in turn decreases the ACB of each individual share that you own.

Similarly, where the corporation implements a reverse stock split, the overall value of the corporation and the overall ACB of your investment does not change. Reverse stock splits decrease the number of shares you own, which in turn increases the ACB per share you own.

Stock dividends

A stock dividend is a dividend paid by the issuance of shares from the corporation paying the dividend. This type of dividend could be paid instead of a cash dividend.

For tax purposes, stock dividends are taxable. In general, the taxable dividend amount equals the increase in paid-up capital of the corporation. This taxable dividend amount will also become the ACB of the shares acquired from the stock dividend.

Spin-offs

Where you own shares of a foreign corporation that went through a spin- off, the ACB of the original shares you own will generally not change. The FMV of the spin-off shares is taxable to you as a foreign dividend and this amount also becomes the ACB of the spin-off shares.

You may be able to make a special election for certain foreign spin- offs. If the election is made, you can allocate the ACB between the parent corporation and the spin-off corporation shares instead of treating the spin-off shares as a foreign dividend. For more details on how the ACB is calculated in this case, ask an RBC advisor for the article on foreign spin-offs.

Dividend Reinvestment Programs (DRIPs)

A DRIP plan allows you to automatically purchase additional shares of the corporation paying the dividend with the cash dividends you receive. Each time a dividend is paid, there is an impact on the ACB of the shares you hold, as the cash gets reinvested in shares as a purchase. Where you're participating in a DRIP program in a non-registered account, you will need to factor in the new purchases made using the cash dividends to determine the ACB of your investment.

What if I don't know my cost?

Sometimes, you may simply not remember what you paid or you may not be able to find the original documents required to determine the proper ACB. In these cases, the "principle of reasonableness" must be relied on to determine an estimate of the ACB. To begin, you need to know, or preferably have some evidence of, when the security was purchased.

If share certificates were purchased, it may be possible to contact the transfer agent to determine when you became the owner of the shares. If shares were purchased through a broker, monthly statements are a great place to start. If those are unavailable, your broker may be able to retrieve the necessary information from storage or archival tapes but there is usually a charge associated with this research.

After the time of purchase is determined, an estimate must be made of the cost. Usually this involves going back through the investment entity's history and using published prices. The price chosen can be a daily close price, weekly, monthly or annual average and will usually depend on how close to the original day the purchase can be determined. Your qualified tax advisor is the best person to recommend which price to use based on the evidence produced.

Where you're participating in a DRIP program in a non-registered account, you will need to factor in the new purchases made using the cash dividends to determine the ACB of your investment.

Worst-case scenario

The Canadian tax system is based on self-assessment and most times, the CRA assesses your return based on the information you provide. However, the CRA also has the right to challenge the information you provide on your tax return. If your reporting is challenged by the CRA, you should have the best possible support for the position you presented on your return.

If a purchase date cannot be estimated or the proof of purchase date cannot be found, one method is to assume the security has a zero ACB. Your qualified tax advisor is the best person to help you with deciding what to do in this situation.

Conclusion

The calculation of capital gains and losses is largely dependent on the ACB of the investment property you hold. As such, it is essential you maintain proper records of your investments. A qualified tax advisor can assist you with determining the ACB of your investments when you are calculating the capital gains or losses from the disposition of your investments.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

Appendix: Historical events that may impact ACB

This appendix discusses some changes to the taxation of capital gains in Canada that may impact the ACB of your investments.

December 1971 — Valuation Day (V-Day)

Before 1972, capital gains were not taxed in Canada. To facilitate the transition for anyone who owned capital property at the end of 1971, the following two methods are available for calculating the ACB of such property if you continue to hold the property without interruption:

Median rule method

Under the median rule, the ACB of the property is the middle figure of the following three amounts:

- Proceeds of disposition
- Valuation Day value
- Actual original cost

If any two of the above values are equal, that amount becomes the ACB.

A corporation must use this method to calculate the ACB of all non- depreciable capital property (other than an interest in a partnership) owned by the corporation on December 31, 1971.

Valuation Day (V-Day) method

There are two Valuation Days and the applicable Valuation Day depends on the type of property you hold. December 31, 1971, is the Valuation Day for all property other than property that is prescribed to be a publicly traded share. The Valuation Day for property that is prescribed to be a publicly traded share is December 22, 1971. The prices of these shares can be found in a schedule in the Income Tax Act Regulations. The Valuation Day value may be used as the ACB of property held on December 31, 1971.

An individual can choose to use this method or the previously discussed median rule method to calculate the ACB of all non-depreciable capital property (other than an interest in a partnership) owned on December 31, 1971. If you choose to use the V-Day method, you must use this method for all non-depreciable capital property (other than an interest in a partnership) owned on December 31, 1971.

February 22, 1994 — Elimination of the $100,000 capital gains exemption

On February 22, 1994, the government eliminated the $100,000 lifetime capital gains exemption. Taxpayers were allowed the opportunity to file a special tax election to “crystallize” previously unrealized gains on capital property in order to utilize any remaining capital gains exemption. The election allowed you to bump the ACB of your capital property, such as your investments, to its FMV or the $100,000 limit, whichever amount was greater.

If you held a security on that date and you are now disposing of it, you may want to go back and check your 1994 tax return to see if the ACB of the security was bumped up. Late elections were allowed for up to three years, with a penalty, so this election may also be found on your 1995, 1996 or 1997 tax returns.