The Navigator

Wealth Management

RBC Wealth Management Services

Currency tax reporting – foreign exchange gains and losses

Calculating and reporting foreign exchange gains and losses on your Canadian tax return

Under Canadian tax rules, you must report all income in Canadian dollars. You may trigger foreign exchange gains or losses (i.e., capital gains or losses) on cash or securities you hold in a foreign denominated currency as a result of fluctuations in the foreign exchange rate.

This article explains tax reporting requirements for cash and various types of securities held in foreign currencies, including what is to be converted, when it is to be converted and at what exchange rate.

For most investors, foreign exchange gains and losses will likely be considered to be capital in nature. However, it is a question of fact in each particular situation whether a foreign exchange gain or loss should be treated as on account of capital or on account of income; therefore, you should speak to your tax advisor to discuss the tax treatment that applies to you. This article explains the tax reporting requirements if you must report these transactions as capital transactions.

Please contact us for more information about the topics discussed in this article.

Different types of investments and their treatment

Publicly traded shares and canadian mutual funds held in a foreign currency

If you sell publicly-traded shares or redeem mutual funds (e.g., mutual fund trust units or shares of a mutual fund corporation) that are denominated in a foreign currency, you may trigger a foreign exchange gain or loss. You must convert the adjusted cost base (ACB) and sale proceeds of the security into Canadian dollars to calculate your capital gain or loss. For Canadian tax reporting purposes, the foreign exchange rate that was in effect on the date of the transaction (i.e., the settlement date of the purchase and the settlement date of the sale) is used to calculate the capital gain or loss in Canadian dollars. If you make several purchases of a security at various times throughout the same year, you may use the average annual exchange rate for these purchases.

The reporting of the capital gain or loss in Canadian dollars captures both the changes in the growth or fair market value (FMV) of the security, as well as gains or losses due to changes in the Canada-U.S. exchange rate.

For example:

Assume 100 shares of America Corp. were purchased at US$83 with a settlement date of January 1 in Year One. After these securities were held for over two years, they were sold and settled on March 26 of Year Three when they were trading at US$120 each. The exchange rates on these two settlements dates are shown in the table below.

Sale of America Corp.	Settlement date	U.S. dollars	Exchange rate	Canadian dollars
Proceeds of disposition	Mar. 26 – Year 3	$12,000	1.0616	$12,739
ACB	Jan. 1 – Year 1	($8,300)	1.5586	($12,936)
Gain/(loss)	–	$ 3,700	–	($197)

Notice how the gain denominated in U.S. dollars (i.e., US$3,700), which reflects only the growth of the shares, can actually be a loss for Canadian tax purposes. The capital loss of C$197 is the amount you would report on your Canadian tax return. The reporting of the capital gain or loss in Canadian dollars captures both the changes in the growth or fair market value (FMV) of the security, as well as gains or losses due to changes in the Canada-U.S. exchange rate. It would be incorrect to simply net the proceeds received in U.S. dollars with the U.S. dollar adjusted cost base (ACB) and convert the gain of US$3,700 to Canadian dollars.

In the example above, if there were several purchases made before the sale, the foreign exchange rate on the settlement date of each of the purchases would be used to calculate the ACB in Canadian dollars, or the annual average exchange rate may be used where several purchases were made in the same year. If only a portion of the shares are sold, a weighted average cost of these shares converted to Canadian dollars would be used to calculate the capital gain or loss.

Due to fluctuations in the foreign exchange rates, it is possible to trigger a capital gain or loss even if the FMV of the security has not changed at the time of sale. For example, when you redeem a U.S. money market fund, the redemption amount and the ACB in U.S. dollars may be the same amount; however, if the foreign exchange rate at the date of purchase and the date of sale vary, you will trigger a capital gain or loss due to changes in the foreign exchange rate. If the example above was for the purchase of a U.S. money market fund for US$8,300, a capital loss of C$4,125 would result even though the redemption amount and the ACB in U.S. dollars has not changed. This capital loss can be attributed to the strength in the Canadian dollar in Year 3.

In addition to the capital gain or loss on the sale or redemption of shares or mutual funds, you may have received income during the year from these securities.

U.S. money market fund	Settlement date	U.S. dollars	Exchange rate	Canadian dollars
Redemption amount	Mar. 26 – Year 3e	$8,300	1.0616	$8,811
ACB	Jan. 1 – Year 1	($8,300)	1.5586	($12,936)
Gain/(loss)	–	nil	–	($4,125)

Distributions from publicly-traded shares or mutual funds held in foreign currency

In addition to the capital gain or loss on the sale or redemption of shares or mutual funds, you may have received income during the year from these securities. For example, the shares of America Corp. may pay dividends, or the units or shares of a mutual fund may pay capital gains distributions, capital gains dividends, dividends, foreign income, interest, other income, or a combination of these amounts to you. If this income is denominated in U.S. dollars, you must convert this income to Canadian dollars using the Canada-U.S. exchange rate on the date the income was received or the average exchange rate for the tax year, when reporting it on your income tax return.

For non-compound interest paying investments, interest is reported on your annual tax returns when it is received.

Negotiable instruments

Notes, bonds, mortgages, debentures, government treasury bills and notes, commercial paper and GICs that are traded on the secondary market are considered negotiable instruments. When these securities are denominated in a foreign currency, there is a foreign exchange gain or loss on the disposition due to currency fluctuations, even if the proceeds are maintained in the same currency or rolled over into similar securities.

For example:

Let's assume a 6% US$100,000 corporate bond was purchased at par with a settlement date of March 1 in Year One. Interest was paid semi-annually each March and September. On the purchase date, C$117,130 was required to buy the bond at the prevailing exchange rate. The bond was then sold at a discount price of 0.98, with a settlement date of November 6 in Year Three.

U.S. currency conversion rates on the relevant days were as follows:

Date	Exchange rate
Mar. 1 – Year 1	1.1713
Sept. 1 – Year 1	1.0496
Mar. 1 – Year 2	0.9870
Sept. 1 – Year 2	1.0701
Mar. 1 – Year 3	1.2890
Sept. 1 – Year 3	1.1031
Nov. 6 – Year 3	1.0720

For Canadian tax purposes:

For non-compound interest paying investments, interest is reported on your annual tax returns when it is received. Where an interest payment date falls on a weekend or a holiday, the interest is paid on the next business day.

The following would be reported for each year in this example:

For Year One, a total of **C$3,148.80** would be reported, calculated as follows:

Sept. 1: US$100,000 x 6% ÷ 2 = US$3,000 x 1.0496 = C$3,148.80

For Year Two, a total of **C$6,171.30** would be reported, calculated as follows:

Mar. 1: US$100,000 x 6% ÷ 2 = US$3,000 x 0.9870 = C$2,961.00

Sept. 1: US$100,000 x 6% ÷ 2 = US$3,000 x 1.0701 = C$3,210.30

For Year Three, a total of **C$8,339.34** would be reported, calculated as follows:

Mar. 1: US$100,000 x 6% ÷ 2 = US$3,000 x 1.2890 = C$3,867.00

Sept. 1: US$100,000 x 6% ÷ 2 = US$3,000 x 1.1031 = C$3,309.30

Nov. 6: US$100,000 x 6% x (66 ÷ 365 days) = US$1,084.93 x 1.0720 = C$1,163.04

The bond would have paid interest in March and September and then additional interest would have been realized from the last regular payment date to the date the bond was sold. Note that Canada Revenue Agency (CRA) will also accept the interest income being converted at the average foreign exchange rate for the year, as long as this method is consistently applied.

In addition, there would be a capital gain or loss, which would include the impact of foreign currency and this would be reported on your annual tax return. The gain or loss is calculated as follows:

A discount instrument, such as a strip bond, BA or T-bill, also produces interest income and/or capital gains or losses.

Bond sold	U.S. dollars	Settlement date and exchange rate	Canadian dollars
Proceeds of disposition	$98,000	Nov 6 – Year Three at 1.0720	$105,056
ACB	$100,000	Mar. 1 – Year One at 1.1713	$117,130
Capital Gain/(Loss)	($2,000)	–	($12,074)

As you can see in this example, the US$2,000 capital loss resulted in a C$12,074 capital loss (including a foreign exchange loss) for Canadian tax purposes. Calculating the gain or loss, first in U.S. dollars and then converting it to Canadian dollars, does not give the same result and is not the correct method for calculating gains and losses. Even though there is interest reported in each year of holding the bond, the large capital loss on the sale is not in any way reduced by the interest income already reported and can only be used to offset capital gains.

Discount instruments

A discount instrument, such as a strip bond, BA or T-bill, also produces interest income and/or capital gains or losses. Once the proper income has been determined, the capital gain or loss (including the foreign currency gain or loss) can be calculated.

For example:

Let's say you purchased a U.S. denominated T-bill for US$9,900 on June 1 with a yield of 4.07%. The T-bill matured on September 1 (91 days) and its maturity value was US$10,000. You decided to sell the T-bill on August 10 for US$9,980. Let's assume that the conversion rate on June 1 was 1.2 and on August 10 it was 1.1. The accrued interest and capital gain/loss are calculated as follows:

1. First interest is calculated from June 1 to August 10:

   Total interest = Purchase price x Effective yield rate x (Number of days T-bill held ÷ Number of days in year of sale)

   $9,900 x 4.07% x (71 ÷ 365) = US$78

2. Once the interest is known, the capital gain or loss can be calculated:

Proceeds of disposition	US$9,980
Minus: interest	$78
Net proceeds of disposition	$9,902
Minus: ACB	$9,900
Equal: Capital gain	$2

T-Bill sold	U.S. dollars	Exchange rate	Canadian dollars
Net proceeds of disposition	$9,902	1.1	$ 10,892.20
ACB	$9,900	1.2	$11,880.00
Capital gain/(loss)	$2	n/a	($987.80)

The interest and the capital gain/loss need to be reported separately on your tax return, even though for investment purposes they may appear to offset each other.

For Canadian tax purposes:

Interest of C$85.80 (US$78 x 1.1) should be reported on your income tax return. (Alternatively, you can use the average U.S. exchange rate for the year if this method is applied consistently.)

A capital loss of C$987.80 should also be reported on your tax return. The same methodology as above is used to calculate the loss. The capital loss in Canadian dollars is affected by the foreign exchange rate changes over the holding period of the discount instrument.

Also, the interest and the capital gain/loss need to be reported separately on your tax return, even though for investment purposes they may appear to offset each other.

Non-negotiable instruments – funds on deposit

Term deposits, non-negotiable GICs, and other investments that are not negotiable are considered to be "on deposit." They are not considered to be disposed of until they are converted to another currency or used to purchase negotiable investments or other assets.

For example:

Let's determine how these instruments should be reported.

Assume a US$20,000 GIC is purchased on May 1 with a 5% interest rate. It matures on June 1 and is rolled over to another U.S. GIC with a 6% interest rate and matures on July 1. On May 1, the Canadian dollar is worth US1.00. On June 1, it is 1.02 and on July 1 it is 1.05. Further, let's assume the average exchange rate for the year is 1.04.

Here is a summary of the transactions

May 1	Conversion	C$20,000 is converted to US$20,000 (exchange rate is C$1 = US$1)
May 1	Purchase	US$20,000 GIC
June 1	Maturity	Principal returned: US$20,000 Interest earned: US$84.93 ($20,000 x 5% x 31/365)
June 1	Purchase	US$20,084.93 GIC
July 1	Maturity	Principal returned: US$20,084.93 Interest earned: US$99.05 ($20,084.93 x 6% x 30/365) Principal balance: US$20,183.98
July 1	Conversion	US$20,183.98 is used to purchase a negotiable instrument, such as a preferred share

Cash you hold in a foreign currency in a safety deposit box, as a traveller's cheque, in a bank account or in a High Interest Savings Account (HISA) is subject to special rules with respect to reporting gains and losses because of fluctuations in foreign exchange rates.

For Canadian tax purposes:

Interest is always reported when paid or when the tax rules require the interest to be accrued. From the above example, the June 1 maturity interest of US$84.93 will be converted to C$86.63 (exchange rate of 1.02) and reported on your annual tax return. Similarly, the July 1 maturity interest of US$99.05 will be converted to C$104.00 (exchange rate of 1.05) and reported.

Alternatively, the two interest amounts could have been added together and then converted using the annual average foreign exchange rate for the year. This would result in ([$84.93 + $99.05] x 1.04) C$191.34 being reported for these transactions. This average annual foreign exchange rate option is especially handy when there are numerous foreign currency income transactions in the year.

In addition, a foreign exchange gain or loss is only calculated when there is an actual conversion of currency or if the principal balance is used to purchase a negotiable investment or other asset. In the above example, when the preferred share is purchased, the July 1 balance will include the interest already reported on your tax return and reinvested in a U.S. dollar GIC. The total US$20,183.98 is converted to Canadian dollars at the foreign exchange rate on the date the funds are converted to Canadian dollars to purchase the preferred share, in this example at 1.05. The capital gain or loss is calculated as follows:

Proceeds of disposition
US$20,183.98 x 1.05 = C$21,193.18

ACB
C$20,000 + $86.63 + $104.00 =
C$20,190.63

Capital gain/(loss)
C$21,193.18 – C$20,190.63 =
C$1,002.55

In this example, subtracting what you have now from what you started with would produce a gain of C$1,002.55, which would be reported on your tax return as a capital gain, and ultimately, only 50% would be taxable.

Cash

Cash you hold in a foreign currency in a safety deposit box, as a traveller's cheque, in a bank account or in a High Interest Savings Account (HISA) is subject to special rules with respect to reporting gains and losses because of fluctuations in foreign exchange rates. For administrative ease, the first C$200 of the sum of all foreign exchange gains and losses on cash are exempt from taxation in a taxation year. If the sum of all the exchange gain or losses for all these forms of cash is in excess of C$200, the excess must be reported for Canadian income tax purposes. Note that this C$200 exemption does not apply to gains and losses realized on the sale of securities denominated in foreign

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currencies.

The CRA considers that a foreign exchange gain or loss has occurred:

a) at the time of conversion of funds in a foreign currency into another foreign currency or into Canadian dollars; or

b) at the time funds in a foreign currency are used to make a purchase or a payment.

For example, let's say you deposit C$100,000 in a U.S. dollar HISA when the Canada-US exchange rate is par. You keep the funds there until the Canadian dollar strengthens, then you either withdraw the funds from the HISA to purchase a publicly-traded stock, or you convert the funds to Canadian dollars. In either case, the CRA considers that a foreign exchange gain or loss has occurred. You must report all foreign currency capital gains related to cash on your Canadian tax return except for the first C$200 that is exempt. If you simply withdraw the cash in U.S. dollars and place the cash in your safety deposit box, there is no foreign exchange gain or loss triggered at this time.

Conclusion

Foreign exchange gains and losses on account of capital are technically required to be converted using foreign exchange rates that are in effect on the settlement date of the applicable transactions. In addition, income received in a foreign currency should be calculated using the foreign exchange rates in effect on the settlement date of the transaction (e.g., the date the interest is received). However, for administrative ease, CRA will also accept the conversion of income transactions using the average annual exchange rate for the year. If this option is used for income transactions, it must be used for all income transactions in the year.

Wealth Management

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