

Investor Insight

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Exchanging Gains for Losses (or Vice-Versa)

Over the past decade, the Canadian dollar has fluctuated significantly against the U.S. dollar. Depending on one's perspective, this has been greeted with either delight or dismay. For individuals with U.S. dollar investments, these swings could produce unanticipated tax consequences.

On the sale of a capital asset, the resulting capital gain or capital loss is the difference between the proceeds received on disposition and the adjusted cost base of the capital asset, less disposition costs. In situations where the capital asset is purchased and/or sold in a currency other than Canadian dollars, the question that generally arises is how to report this transaction for Canadian tax purposes.

It is the Canada Revenue Agency's position that each transaction must be reported in Canadian dollars using the foreign exchange rates in effect at the relevant times. Thus, the proceeds of a disposition would be determined using the foreign exchange rate prevailing at the time the capital asset is sold; conversely, the adjusted cost base would be calculated using the foreign exchange rate at the time the capital asset was purchased.

For example, consider the situation where an individual purchased a share in Company X for US\$1,000 when the foreign exchange rate was at par. The individual then sold the share in Company X at a later date for US\$900 when the foreign exchange rate was 1.1111. Although the individual would have realized a loss on the shares from a U.S. dollar perspective, assuming no disposition costs, for Canadian tax purposes the individual would have no gain or loss as the proceeds of disposition in Canadian dollars (i.e., $US\$900 \times 1.1111 = C\$1,000$) would be equivalent to the adjusted cost base in Canadian dollars (i.e., $US\$1,000 \times 1.0000 = C\$1,000$).

As this example illustrates, even though a transaction may appear to produce one result in a foreign currency, when the fluctuations in foreign exchange rates between the dates of purchase and sale are contemplated, the results for Canadian tax purposes can be significantly different than expected.

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