Identical Properties

One of the special rules in calculating capital gains or losses relates to "identical properties". It is important to understand how this rule works, to ensure you are correctly reporting your capital gain or loss when completing your tax returns.

What is the meaning of Identical Properties?

Canada Revenue Agency (CRA) Interpretation Bulletin IT-387R2 defines "identical properties" as "properties which are the same in all material respects, so that a prospective buyer would not have a preference for one as opposed to another".

Perhaps the most common examples of identical properties are shares of the same class of the capital stock of a corporation or units of a mutual fund trust. Other examples of identical properties are:

- Gold bullion and gold certificates (or bullion and certificates of the same precious metals).
- Bonds, debentures, bills, notes or other similar obligations issued by the same debtor that are identical in respect of all rights attached thereto.
    - However, strip bonds are not considered to be identical to bonds of the same issue from which the interest coupons have not been detached.

Why is this concept important?

It is important to understand what identical properties are, because the adjusted cost base (ACB) of each of the identical properties held at any particular time will be considered to be the same. In other words, the ACB of each identical property is calculated by adding together the cost base of all such properties and dividing by the number of such identical properties to arrive at an average cost, which will then be the ACB for each property.

With mutual funds, you often buy and sell several identical properties at different prices over a period of time. This means you must re-calculate the average cost of each property in the group at the time of each purchase to determine your ACB.

Example:

Josée bought 1,000 units of a mutual fund trust in 2007 at a total cost of $10,000. She chose to reinvest the annual income distributions in more units.

- In 2008, income distributions of $500 were reinvested at $10.55 per unit.
- In 2009, income distributions of $750 were reinvested at $11.10 per unit.
- In 2010, she sold 500 units at $12.15 per unit.
- In 2011, income distributions of $400 were reinvested at $12.50 per unit.

If Josée sells the rest of her units in 2012 at $12.88 per unit, what will her capital gain be?

Step One: Determine the ACB of Josée's mutual fund units before she sells them in 2012.

Calculation of Josée's ACB

Year	Description	Total Cost ($)	Number of Units	Average Cost per Unit ($)
		(A)	*(B)*	*(A/B)*
2007	Purchase	$10,000.00	1000.00	$10.00
2008	Reinvested Distribution	$500.00	47.39	$10.55
	NEW COST	$10,500.00	1047.39	$10.02
2009	Reinvested Distribution	$750.00	67.57	$11.10
	NEW COST	$11,250.00	1114.96	$10.09
2010	Redemption	$5,045.02	500.00	$10.09
	BALANCE IN FUND	$6,204.98	614.96	$10.09
2011	Reinvested Distribution	$400.00	32.00	$12.50
2012	**NEW COST**	$6,604.98	646.96	$10.21

Step Two: Subtract the proceeds of distribution from the ACB to determine the capital gain.

As can be seen from the preceding table, the ACB of the mutual fund units in 2012 is $6,604.98.

To calculate the proceeds of distribution, multiply 646.96 units by $12.88, which is $8,332.84.

Therefore the capital gain is $8,332.84 minus $6,604.98, which is $1,727.86.

Note: It is important to understand that a disposition of an identical property will NOT affect the cost base of each unit of the investment, since the cost base of each unit is determined by dividing the total amount invested (including reinvested distributions) by the number of shares purchased. This can be seen in the calculation above, where after the redemption of 500 units in 2010, there is no change to Josée's average cost per unit.

Special situations

Where some identical properties were acquired prior to 1972 and some after December 31, 1971 (known as "Valuation Day"), special rules apply, because capital gains were not taxed at all prior to 1972. Thus, a separate ACB is calculated for all properties acquired before 1972 and one for those acquired after 1971. Pre-Valuation Day shares are deemed to have been redeemed first, until that group is depleted. Details and examples of how the rule works can be found in CRA's Interpretation Bulletin IT-78.

Where shares are acquired under an employee stock option agreement, and the taxpayer already holds identical shares, there is a 30-day rule that allows the taxpayer to designate the shares acquired under the option agreement (the "Option Shares") to be the ones disposed of, thereby avoiding a presumption that the older shares with a lower cost base were disposed of first. The key is that the disposition of the Option Shares must occur within 30 days after the acquisition; and there must be no other acquisition or disposition of identical securities in the intervening period. The taxpayer must also make a designation in the tax return for the year.

Example

- Liam bought 500 shares of his employer on the open market on January 30, 2012.
- He acquired 1,000 shares under employee stock options on May 31, 2012.
- On June 1, 2012, he sold 1,200 shares.
- In his 2012 income tax return, he designates the 1,000 stock options shares as constituting part of the shares he sold.
- The 1,200 shares he sold will be deemed to be comprised of the 1000 stock option shares he sold and 200 of the 500 shares he bought on the open market on January 30, 2012.

Planning Issues

Many investors maintain investment accounts with multiple financial institutions. It is not unusual to find that the same security holding (be it a stock, bond or mutual fund) is recommended by their different investment advisors and held at different institutions. Thus, you may hold 1,000 ABC shares in your TD Waterhouse account, 500 ABC shares in your Nesbitt Burns account, as well as 200 ABC shares in your Wood Gundy account. Now let's say you sell the 200 ABC shares in your Wood Gundy account. When you report the capital gain or loss for the year, it is important to realize that you have to take into consideration the cost base of **ALL** your ABC shares, and not just the ones you hold at Wood Gundy. Let's say your intention in selling the ABC shares in your Wood Gundy account was to trigger a capital loss, your objective may not be achieved if you have an accrued capital gain in your other accounts. In fact, you may have inadvertently triggered a capital gain! To avoid organizational nightmares and to ensure that your cost base calculations are accurate, it may make sense to consolidate your investments with one financial institution rather than have them spread among several different institutions.

The concept of identical properties is also relevant for the Superficial Loss rules. If you sell property to trigger a capital loss but an identical property is acquired within 30 days before or after that sale, the superficial loss rule will apply to disallow that capital loss for tax purposes.

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