CRA: Pay Less Tax if the Stock Market Crashes

Description

It’s been an awful start to the year for investors, and it doesn’t appear that the rest of 2020 could get much better. Fortunately, the Canadian Revenue Agency (CRA) offers some reprieve to investors in a down year like this.

Canada’s economy, along with the rest of the world, is now on brink of recession. The dramatic slide in the price of crude oil coupled with the ongoing disruptions from the coronavirus pandemic have destroyed unimaginable wealth in just a few weeks.

There are reasons to be skeptical of a quick recovery at this point. Russia and Saudi Arabia both seem committed to a long and gruesome price war in the crude oil market, while the rate of coronavirus infections in North America and Europe is steadily climbing. In short, 2020 could be a year of economic losses for most investors.

CRA rules could buttress the impact of this downturn. The agency allows taxpayers to offset their capital gains against capital losses in any given year. This method, known as tax-loss harvesting, could save you a lot of money if the market continues to plummet.

Here’s a quick example:

Lost money on cannabis

At the time of writing, **Aurora Cannabis Inc.** has lost roughly 48.3% of its value since the start of this year. To recover that amount, Aurora’s stock will need to surge a jaw-dropping 93.4% by the end of 2020. That seems unlikely.

However, **Shopify** stock is *up 14.7%* this year, making it one of the few companies to survive the ongoing bloodbath on Bay Street.

Assuming you invested $1,000 in both Shopify and Aurora stock at the start of the year and sold both today, you could offset your $147 gain in Shopify against your $517 loss on Aurora to lower your tax burden for 2020.

This method applies across your portfolio, so you might want to consider selling the stocks that have lost value and are likely to suffer more throughout the rest of this year.

CRA caveats

There are, of course, caveats that investors must keep in mind while trying to take advantage of tax-loss harvesting. First, this strategy applies only to non-registered accounts. Gains in Tax-Free Savings Accounts (TFSA) or a Registered Retirement Savings Plan (RRSP) are exempt from taxes, so losses can't be harvested.

That's why losing money in a TFSA or RRSP is one of the biggest mistakes investors often make.

Second, investors need to keep an eye on the impact of foreign exchange. If you hold U.S. stocks or bonds in your account, your investment loss could be offset by the fluctuating value of the Canadian dollar.

For example, if you lose 2% in a U.S. stock but the Canadian dollar depreciates 2%, you need to reconcile that for tax-loss harvesting.

Bottom line

An economic downturn and severe recession seem likely this year. As a consequence, investors should brace for capital losses in 2020. However, these losses could offset some taxable gains and mitigate your overall tax burden for the year.

Tax-loss harvesting can give your portfolio a much-needed boost.

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