



Article reprint

Lawyer's Briefs: Deductibility of securities trading losses

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At issue

Business losses incurred in the course of securities trading may be deductible to a taxpayer where it can be shown that they arose while the person was either a "trader" as defined under the Income Tax Act, or was otherwise engaged in an "adventure in the nature of trade". To determine whether this latter characterization applies, a court will generally weigh five factors:

1. Frequency of transactions
2. Duration of holdings
3. Intention to acquire for resale at a profit
4. Nature and quantity of securities
5. Time spent on activity

Whether considering any one of the factors or the set of five together, there is no bright line test to know for certain that a given taxpayer has satisfied the requirements. So while there is plenty of case law fleshing out these factors, taxpayers who are at odds with the Canada

Revenue Agency are often left to plead their unique facts before a judge.

Here's how a few taxpayers fared recently in litigation.

Walsh v. The Queen, 2011 TCC 341

Mr. Walsh had retired from his chartered accountancy practice due to health issues, but wished to continue in a business that was compatible with his skill set. Eventually he settled upon securities trading, purchased a sophisticated software package and participated in both online and in-person training and discussion groups.

For the two years in issue, there was only a small amount of trading activity, but this was not determinative against him.

The claimed expenses were not aggressive attempts to allocate household expenses to a home-office or the like, but were specifically related to the investing activity. The bulk of them were however for training, and the relative timing of the outlays was critical.

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Rather than being in the preliminary exploitation of a business opportunity, Mr. Walsh was held to be in a pre-exploitation stage, and therefore the \$26,500 losses were held to be personal and not deductible.

Zsebok v. The Queen, 2012 TCC 99

The taxpayer filed his 2001 to 2004 tax returns together in 2006, claiming business losses due to online trading. These losses were denied, and thus the appeal to the court.

Though trades occurred on only 5-10% of the available trading days, there was a discernible strategy for identifying highly volatile shares trading in high volume, and trades ensued therefrom. At one point, Mr. Zsebok even dipped into his RRSP account to fund his non-registered margin account, exacerbating the losses with the fact that he had to pay tax on those withdrawals.

At points the judge viewed the activities as "feverish", "foolishly" undertaken, and in pursuit of "get rich quick dreams", though in the end unsuccessful. Despite these impressions and misgivings about the late-filed returns, the issue before the court was whether the actions constituted an adventure in the nature of trade. On this point, the taxpayer won on 3 of the 4 years' assessments.

Mittal v. The Queen, 2012 TCC 417

Reproduced in this judgment is a nine-part business plan that includes personal development goals, buy and sell rules, monetary and time commitments, and even a contingency plan: "Take one week off from the markets to reevaluate my trading, current market conditions, my risk management and my mental and emotional stability. If a vacation is necessary, take one."

The business plan guided the investing activities of Mr. Mittal, a retired engineer and self-described workaholic. In the judge's view, this was an organized and businesslike approach to investing, though ultimately leading to losses of almost \$70,000 over two taxation years.

The combination of a well-documented plan and carefully tracked activities contributed to the judge's ruling that there was a clear intention to conduct business activity, despite the lack of success. Together with the favourable findings on the other factors, Mr. Mittal was entitled to his deductions.

Practice points

- 1) Understanding the five factors will help a taxpayer decide whether it is worth the cost and aggravation to appeal an assessment.
- 2) The act of good recordkeeping can be strong evidence of a taxpayer's intentions, on top of the obvious benefit of quantifying claims.
- 3) The implication of successfully claiming a deduction would likely be that trading gains would be fully taxable, rather than one-half treatment of capital gains. Accordingly, would-be claimants should obtain tax advice before taking a position, as this could have lifelong repercussions.