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REFDATE 140814

SUBJECT Capital Losses - Health & Welfare Trusts

SECTION 3(b); 111(1.1)(a); 127.52(1)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Whether a HWT is permitted to deduct net capital losses when computing taxable income under Division C and/or adjusted taxable income under Division E.1?

POSITION: Yes.

REASONS: See response.

August 14, 2014

Taxpayer Services Directorate	Income Tax Rulings Directorate
Taxpayer Services and Debt Management Branch	Business and Employment Division
	Tom Baltkois

Attention: Yves Thivierge 2013-050669

Capital Losses - Health & Welfare Trusts

We are writing in response to your email dated September 27, 2013, in which you requested clarification as to whether health and welfare trusts ("HWTs") are permitted to incur capital losses and deduct net capital losses when computing taxable income under Division C and/or adjusted taxable income under Division E.1 of the Income Tax Act (the "Act").

Our Comments

The position of the Canada Revenue Agency ("CRA") on the taxation of HWTs is discussed in Interpretation Bulletin IT-85R2, Health and Welfare Trusts for Employees. As you are aware, IT-85R2 does not discuss allowable capital losses and whether the net capital loss carryover provisions are applicable to HWTs.

Guide T4013, T3 - Trust Guide 2013, addresses a trust's ability to utilize net capital losses. In particular, Guide T4013 discusses the carry forward and application of prior year net capital losses to reduce or eliminate taxable capital gains realized in a particular year. While Guide T4013 does not specifically address whether the net capital loss carryover provisions apply to HWTs, it does not indicate that HWTs are precluded from applying net capital losses in computing taxable income under Division C of the Act and adjusted taxable income under Division E.1 of the Act.

Guide T4013 also includes a brief discussion of Schedule 12, Minimum Tax, and indicates that one of the most common scenarios under which a trust may become liable for the alternative minimum tax ("AMT") occurs when the trust reports taxable capital gains. This was the specific concern addressed in document 2004-009364.

Document 2004-009364 concluded that where a HWT has expenses that were otherwise deductible and not allowed because of the limitation discussed in paragraph 12 of IT-85R2, it will be permitted to use those expenses to reduce its adjusted taxable income for purposes of AMT. This position was confirmed in document 2013-048406. In the absence of these positions, a HWT may be subject to AMT on the non-taxable portion of capital gains it reported in the year.

The comments contained in documents 2004-009364 and 2013-048406 were not intended to suggest that a HWT is not permitted to realize allowable capital losses, nor should these comments be interpreted to mean that a HWT is not permitted to apply net capital losses when computing its taxable income under Division C of the Act or its adjusted taxable income under Division E.1 of the Act.

To determine whether a HWT is permitted to deduct net capital losses in computing its trust income subject to tax, it is necessary to consider the wording of paragraph 12 of IT-85R2. As you are aware, in computing trust income subject to tax, paragraph 12 of IT-85R2 permits a HWT to deduct certain expenses, premiums, and benefits to the extent of its gross trust income. Under a strict interpretation of paragraph 12 of IT-85R2, it could be argued that net capital losses are not deductible by HWTs as they are not specifically identified under paragraph 12(a), (b), or (c) as amounts which may be deducted in computing trust income subject to tax.

It is important to note, however, that paragraph 12 of IT-85R2 provides the rules for amounts that may be deducted in computing trust income subject to tax; it does not provide rules for determining the gross trust

income of a HWT. In accordance with paragraph 11 of IT-85R2, the gross trust income of a HWT includes its income from all sources. Consistent with section 3 of the Act, a HWT's gross trust income for a year includes its taxable capital gains realized in the year in excess of its allowable capital losses realized in the year. As you know, a net capital loss for a year generally arises when allowable capital losses exceed taxable capital gains. In our view, it would be inequitable to prevent a HWT from reducing taxable capital gains through the application of net capital losses, given that a HWT effectively applies allowable capital losses on a current basis when determining its gross trust income for a year.

The HWT would have to follow the rules in subsections 111(1.1) and 127.52(1) of the Act when applying net capital losses. In addition, any deductions made by the HWT under paragraph 12 of IT-85R2 may not exceed its revised gross trust income (i.e., after application of net capital losses). This ensures that a HWT may not create a non-capital loss for purposes of Division C of the Act through the application of net capital losses and preserves the intent of paragraph 12 of IT-85R2.

A HWT must first apply net capital losses and make the various adjustments required by paragraphs 127.52(1)(b) through (j) of the Act when computing adjusted taxable income for purposes of Division E.1 of the Act. The HWT will then be permitted to deduct any expenses, premiums, and benefits that were otherwise deductible and not allowed because of the limitation discussed in paragraph 12 of IT-85R2 to further reduce its adjusted taxable income for purposes of Division E.1 of the Act.

We trust these comments will be of assistance to you.

Yours truly,

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Manager

for Director

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