Last resort: Write it off

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There may be a silver lining for investors stuck holding depressed stocks and mutual funds: tax-loss selling.

The strategy is actually quite simple: If you own securities that have gone down in value, you may wish to sell them to realize a capital loss.

A capital loss must first be applied against any capital gains in the current year. Once current-year capital gains have been used, the balance of the loss can either be carried back to offset capital gains in any of the three prior years or be carried forward indefinitely to offset capital gains in future years.

Investors who wish to hold on to those losers in the hopes of a longer-term recovery can still engage in tax-loss selling by selling the stock, realizing the loss, and buying it back again.

The key to making this strategy work, however, is to watch out for the "superficial loss" rule. A superficial loss occurs when you sell property for a loss and buy it back within 30 days. The rule also applies if your spouse or partner (or a corporation controlled by you or your spouse or partner) buys it back within 30 days.

If you get caught by the superficial loss rule, your capital loss will be denied and added to your adjusted cost base (tax cost). That means you can still realize the benefit of the loss, but only when you ultimately sell the investment.

Thinking about realizing the loss through an in-kind contribution to a registered plan, such as your RRSP or TFSA?

Be forewarned that a loss on such a transfer will be denied. Instead, consider selling the investment outside your registered plan, realizing the loss and contributing the cash from the sale into your registered plan. Wait 30 days to avoid application of the superficial loss rules and then buy back the original investment inside your registered plan.

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