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

**PRINCIPAL ISSUES:** Annual taxation of interest on stripped bonds

**POSITION TAKEN:**
Interest accrued to anniversary day of contract - clarification of definition of anniversary day

**REASONS FOR POSITION TAKEN:**
In accordance with definition of anniversary day in subsection 12(11)

G. Moore
February 27, 2002

Dear XXXXXXXXXX:

Re: Anniversary Day of Stripped Bonds

This is in reply to your correspondence of February 12, 2002, in which you ask
for our interpretation concerning the income tax consequences of disposing of a
stripped bond.

You purchased a stripped bond on March 26, 2001. It is your understanding that
you would not report any interest income for the 2001 taxation year. You also
believe that if you sold the stripped bond prior to March 1, 2002, you would
report the difference between the selling price and the purchase price as a gain
but you would not have to report any interest income.

Our Comments

It appears that the situation you describe concerns a completed or proposed
transaction and we are unable to provide any confirmation of the tax
consequences except, with respect to a proposed transaction, in the context of
an advance income tax ruling. Confirmation of the tax consequences respecting a
completed transaction must be obtained from the local tax services office. We
can offer, however, the following general comments.

In our view, a stripped bond is a "prescribed debt obligation" by virtue of
paragraph 7000(1)(b) of the Income Tax Regulations (the "Regulations") with the
result that by virtue of paragraph 7000(2)(b) of the Regulations and subsection
12(4) and 12(9) of the Income Tax Act (the "Act"), interest thereon must be included in income over the period of ownership of the stripped bond. Generally, the interest income accrued on a stripped bond at its anniversary day will be included in income in each taxation year in which a taxpayer owns a stripped bond on its anniversary day. The anniversary day is generally the date when a stripped bond was initially issued and each one year anniversary thereafter. However, when an investor disposes of a stripped bond, this triggers an anniversary day and subsection 12(4) of the Income Tax Act (the "Act") requires the investor to report the accrued interest up to the date of disposition. The amount of interest so included in computing income of the investor for the year is added in computing the cost to the investor of the stripped bond by virtue of subsection 52(1) of the Act. On a sale of a stripped bond, a capital gain could result if the proceeds of disposition are greater than the adjusted cost base of the bond (adjusted by any increase under subsection 52(1) of the Act). Similarly, a capital loss could result where proceeds of disposition are less than the adjusted cost base.

We trust that these comments will be of assistance.

Yours truly,

Paul Lynch
for Director
Financial Industries Division
Income Tax Rulings Directorate
Policy and Legislation Branch
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