

# The TaxLetter®

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Your Guide to Tax-Saving Strategies

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## TAXPLANNING

*Don't let your generosity turn into a present for the tax man*

# Gift and get

**Samantha Prasad LL.B.**

May ushers in spring flowers and warmer weather. It also closes the door on another tax year. And, for the lucky ones, it is also the month when tax refunds start to come in.

Many of you may be wondering what to do with this extra cash. Perhaps celebrate the windfall with gifts to family members?

That's fine – but if you have a generous nature, be careful about what you give your spouse or kids. Otherwise, you may wind up having to wrap a little present for the tax man too.

Unlike the U.S., Canada does not have a tax on gifts of money or property to family members (see below). However, there are a variety of other tax rules that can be triggered when gifting between members of a family.

Obviously these rules would

not apply to your typical small gift. But what if you wanted to make a grand gesture, such as turning over the cottage property to your kids? Or giving a large amount of cash to your family? That's when it gets tricky.

Subject to certain exceptions, the tax rules have two main purposes: to ensure that the CRA gets their fair share of the tax on any accrued gain, and to prevent “abusive” income splitting transactions among related persons.

**Inadequate Consideration.** This is where you transfer property to a spouse or child (or any person not at arm's length) for consideration less than fair market value. In cases like this, your “deemed proceeds” will be adjusted upward to the fair market value of the transferred property.

This won't add up to much if the fair market value of the property is not more than the cost of the property to you. For example, if you gift a used car to your kids, chances are that the fair market value of the car has not gone up.

However, if the property has

increased in value since you acquired it, there will be a capital gains tax on the gift. The silver lining (however thin) is that if you transfer the property by way of a gift to your loved one, the cost of the property to them will also be adjusted upward. As a result, the tax hit is only on you, the gift-giver.

**Transfers of Property to a Spouse.** There is an exception to the rules I've pointed out relating to gifts to a spouse or spousal trust.

In the usual case, and subject to the comments below, a transfer of a property to a spouse will automatically occur on a tax-free rollover basis, unless you elect otherwise.

This also applies to any property that is transferred to a former spouse as the result of a settlement upon marriage breakdown.

However, this spousal rollover is only valid where both spouses (or spousal trust) are Canadian residents at the time of the transfer. (Note: if the gift is to a spousal trust, your spouse must be the only one, during his or her lifetime, entitled to all of the income or capital of the trust.)

**Attribution on a Transfer to a Spouse or Minor Child.**

Despite the lax rules relating to gifts to spouses, the ubiquitous attribution rules will still sneak up on you in respect to gifts of property to your spouse or a minor child that create income. Specifically, any income from the gifted property will be included in your income.

The attribution rules will also come into play in the case of a loan or incurred indebtedness on the transfer of a proper-

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ty, unless the prescribed rate of interest (currently one per cent) is charged and paid for each year the loan is outstanding.

And if you think that the attribution rules have exhausted their reach, think again: any capital gain realized on a sale or other disposition by your spouse will also be attributable to you.

Happily, though, this rule regarding capital gains does not apply to your minor children. This means that you should be able to legitimately split capital gains with your kids.

So if you're asking yourself what the point of gifting to your kids or spouse is if you're not going to get any benefits (other than love and gratitude), here are a couple of planning tips to keep in mind:

✎ There is no attribution where the property is received from a non-resident (i.e., this is useful if your kids have grandparents that spend a majority of their time in Florida).

✎ Gift investments with low current yield but high capital gain potential to your kids: even though the income may be attributed to you, the capital gain will be taxed to your kids and subject to their tax rates.

✎ "Child tax benefits" accumulated directly in segregated bank accounts for the benefit of your kids are considered funds of the child rather than the parent.

✎ If gifting cash, then you should consider structuring the "gift" as a loan and charge the prescribed rate of interest – since the prescribed rate is only one per cent, this should hopefully not cause much of a financial burden to your spouse or kids (note – if loaning to your minor kids, you should consider using a family trust to be the debtor).

And the beauty of this prescribed loan is that once made, you can lock into the one per cent

rate for the lifetime of the loan.

### Transfers to Adult Children

Transfers to adult children (18 years of age or older) can be made without the attribution rules kicking in; the income will be taxable to your kids. (But beware of the rule regarding inadequate consideration.)

You can transfer your home by gift. If it was properly designated as your principal residence for each year you owned it, the transfer will be exempt from tax. (If your home was only a principal residence for some years and not others, the portion of the exempt gain is accordingly pro-rated.)

### Principal Residence

To qualify as a principal residence, you (or your spouse or child) must have ordinarily inhabited it. A transfer of a second home i.e., a non-principal residence, can be made to your adult and/or married child and qualify as a principal residence for them.

Assuming the home remained your child's principal residence, you will be liable for any accrued gain up to the time of the transfer to your child. However, any further gain would be exempt.

One perk about gifting your principal residence to a family member: In Ontario, land transfer tax will not be triggered since this tax is based on the consideration paid by the person receiving the property.

When documenting the transfer with the registry office, you should be aware that the consideration is "nill" as it is a "gift for natural love and affection" – this way, the family member receiving your gift won't have to cough up cash to the Ontario government on the transfer.

And for those of you living in Toronto, this is a double gift since you will also avoid the additional municipal land transfer tax (for us

unlucky ones within the GTA, it would otherwise result in double the land transfer tax when added with the provincial tax).

### Joint Liability

Beware, however, of section 160, which is designed to prevent you from avoiding tax by transferring property to your family members.

You will be jointly and severally liable with your family for any tax that you have to pay, not only for the year of the gift, but also any preceding year.

Although this liability is limited to the extent that the fair market value of the gift exceeds the value of the consideration (usually nothing where a gift is involved), there is no limit on the interest on tax amount for which either party would be liable.

The 'Gift Tax' rules were repealed back in 1971 as part of the major tax reforms of that year.

The rationale behind this change was that since any accrued gains on capital assets would be taxable at death, the combination of this tax with the gift tax would result in a huge tax hit upon death.

However, the United States has not been so kind, and continues to tax gifts by any individual. But if you are not gifting property that is located in the U.S., don't worry about gifts to family members.

The U.S. gift tax will generally not apply to intangible property by a non-U.S. citizen or gifts of tangible personal property and real property by a non-U.S. citizen if the property is not located in the US. If, however, you are a U.S. citizen (even if you are resident in Canada for tax purposes), the U.S. gift tax rules still apply. So be sure to consider the U.S. rules before making any substantial gift. □