Family Transfers Can Have Tax Effects

Looking to give major gifts of property or investment assets to family members? The good news is that unlike the U.S., Canada does not have a gift tax on transfers of money or property to your family. But you're not getting off unscathed. There are a variety of other tax rules that can be triggered by a gift to your spouse or kids. Here's what to watch for.

Obviously tax rules related to gifts would not apply to typical gifts such as a sweater or an iPhone. But it gets tricky when you want to give, say, the cottage to your kids, or a large amount of cash to family members so they can invest on their own.

Subject to certain exceptions, the tax rules have two main purposes: 1) to ensure that the Canada Revenue Agency collects the tax on any accrued gain; and 2) to prevent "abusive" income-splitting transactions among related persons.

Inadequate consideration

Where you transfer property to a family member (i.e., any non-arm's length person) for consideration less than fair market value, your "deemed proceeds" will be adjusted upward to the fair market value of the transferred property. This may not mean much if the fair market value of the property is not more than the cost of the property to you (i.e., 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, you will have to pay a capital gains tax on the gift equal to the increase in value. The silver lining (however thin) is that if you transfer the property by way of gifting it to a loved one, the cost of the property to them will also be adjusted upward so that the tax hit is only to you, the "giftor."

Transfers of property to a spouse

There is an exception to these rules for gifts to a spouse. 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 (i.e., you are deemed to have transferred the property at your cost to your spouse, so there is deemed to be no capital gain).

Note, though, that this also applies to any property that is transferred to a former spouse as a result of a settlement upon marriage breakdown. However, this spousal rollover applies only where both spouses are Canadian residents at the time of the transfer. But the net effect is that you, as the gift or, do not get hit with a deemed capital gain.

When the attribution rules kick in

Even though you may gift property to a spouse basically tax free, the attribution rules can still sneak up on you if that gift creates income (and that includes gifts made to a minor child). Specifically, any income arising from the gifted property will be included in *your* income.

The attribution rules will also kick in for a loan or incurred indebtedness on a transfer of property, unless the prescribed rate of interest (currently 1%) is charged and paid for each year the loan is outstanding.

But, wait, there's more! Any capital gain realized on a sale or other disposition by your spouse will *also* be attributable to you. So even if you can transfer a property to your spouse tax-free, when she or he sells it, the capital gain – if any – will again be taxed in your hands. Happily, though, this rule relating to capital gains does not apply to your minor-age children. Which means you should be able to legitimately split capital gains with your kids.

So what's the point of gifting to your kids or spouse if you're not going to get any tax benefits? For starters, there's love and gratitude (one hopes!). But here are a few planning points to consider as you weigh up your options:

- **The non-resident gambit.** There is no attribution where the property is received from a non-resident (i.e., this is of use if your kids have grandparents who spend a majority of their time in, say, Florida or some other sunny place abroad).
- **The low-yield manoeuvre.** It's a good idea to 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 (lower) tax rates.
- **An account of their own.** "Child tax benefits" accumulated directly in segregated bank accounts for the benefit of your children are considered funds of the child rather than the parent.

Transfers to adult children

Transfers to adult children (18 years of age or older) can be made without the attribution rules kicking in, so that the income will be taxable to your them, not you. (But beware of the rule regarding inadequate consideration, which I mentioned above.)

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