Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Transferring capital losses to your spouse

You and your spouse may make different investment choices. As a result, you may have unrealized capital losses that your spouse may benefit from. This article discusses how you may be able to transfer unrealized capital losses to your spouse which may help lower your overall family tax bill. Please note that if your spouse has unrealized capital losses, it may be possible for your spouse to transfer their unrealized capital losses to you in the same manner.

Note that any reference to spouse also refers to a common-law partner.

Capital gains and losses

If you have unrealized capital losses that you are unable to use personally and your spouse has taxable capital gains that would be subject to tax, you may want to consider transferring your unrealized capital losses to your spouse. Even if you can use the losses yourself, you may want to transfer your capital losses to your spouse if your spouse is in a higher marginal income tax bracket and has taxable capital gains that would otherwise be subject to tax at a higher rate.

Capital losses can be used to offset capital gains but generally only if the gains and losses are reported by the same person. However, you may be able to use the superficial loss rules to transfer an unrealized capital loss to your spouse.

It is important you consult with your tax advisor prior to implementing this strategy to determine if you could benefit from it. As a result, the financial benefit of implementing this strategy may be partially reduced by any professional fees incurred.

A simple share transfer does not work

If you simply transfer your securities to your spouse, the income attribution rules will prevent the loss from being realized in your spouse's hands, and you will not achieve your goal. This is because when securities are transferred from you to your spouse without your spouse paying fair market value (FMV) consideration, capital gains or losses and future income from those securities are attributed back to you for tax purposes.

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The income attribution rules do not apply between spouses if both of the following occur:

- You sell the securities at market rate to your spouse and your spouse pays you for the securities; and
- You report the disposition for tax purposes at FMV on your tax return.

A strategy that may work

You may be able to transfer a portion of your unrealized capital losses to your spouse by selling the securities in a loss position to your spouse at FMV. Your spouse would need to use their own funds to purchase these securities and would have to hold these securities for at least 30 days. They could then sell the securities to a third party to realize the loss. You would need to report the sale to your spouse on your tax return.

Using this strategy will trigger the superficial loss rules. These rules apply when:

a. During the period that begins 30 days before and ends 30 days after the settlement date of the disposition which resulted in the loss, you or a person affiliated with you (e.g., your spouse) acquires the identical property that was sold at a loss; **and**

b. At the end of that period (e.g., 30 days after the settlement date of the disposition), you or a person affiliated with you (e.g., your spouse) owns the identical property.

Once the superficial loss rules are triggered, you cannot claim the capital loss. The amount of the capital loss is not lost but rather added to the adjusted cost base (ACB) of the security, which now belongs to your spouse. Once your spouse sells the security on the market, they will realize the loss.

Examples of potential tax savings

Example #1: One spouse has capital losses and the other spouse has capital gains

Paul currently owns securities with an ACB of $100,000 and a FMV of $10,000; thus, he has an unrealized capital loss of $90,000. He wants to sell the security; however, he cannot use the capital loss. Unfortunately, he has had a spell of losses in the last three years and has no prospect of a capital gain any time soon. Paul's spouse, Louise, is a sharp investor and realizes capital gains almost every year. This year alone she already has more than $90,000 in capital gains. Paul and Louise are wondering if there's a way they can take advantage of Paul's losses to ease the tax bite for Louise as a result of her capital gains.

Paul could sell the securities to Louise at fair market value. If this is done, it is imperative that Louise purchases the securities from Paul **at FMV with her own money** so that the income attribution rules do not apply.

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At this point, Louise's ACB is $10,000, which is the amount she paid for the securities.

Louise must hold the securities for at least 30 days from the settlement date after purchasing them from Paul. This is an important point because if she sells sooner, there will be no superficial loss, and thus the objective of this strategy will be missed entirely.

After holding the securities for at least 30 days, the superficial loss rules are triggered and Paul is denied the loss. The $90,000 loss is added to the ACB of the securities. Thus, Louise now owns the securities with an ACB of $100,000 ($10,000 the amount she paid to Paul plus Paul's $90,000 denied loss).

To realize a loss, Louise will need to sell all of her securities to a third party. Assuming the value of the securities hasn't changed, her proceeds of disposition would be $10,000. This will result in a capital loss of $90,000. This can be used by Louise to offset her capital gains.

Paul must also report the sale to Louise at FMV ($10,000) on his tax return even though the loss is denied. Otherwise, the transaction may be treated on a rollover basis and Paul would not have realized the loss on the transaction.

The following tables summarize the overall tax implications of this example:

Summary of the tax implications to Louise	
Proceeds of disposition upon final sale in the market	$10,000
Less her ACB *($10,000 + $90,000)*	($100,000)
Capital loss to be reported by Louise	**$90,000**

Summary of the tax implications to Paul	
Capital loss on the securities sold to Louise *(transferred at FMV)*	($90,000)
Capital loss denied because of the superficial loss rules	$90,000
Capital loss to be reported by Paul	**$0**

Tax savings for the couple

The following calculation shows the approximate tax savings assuming Louise is taxed at a marginal tax rate of 46%[1] and Paul cannot make use of the capital losses on his own:

Increase in Paul's taxes as a result of the transfer (*since he could not make use of the capital loss on his own)*	$0
Decrease in Louise's taxes as a result of the transfer *($90,000 x 50% inclusion rate x 46%[1] tax rate)*	($20,700)
Total tax savings relating to Louise's use of the capital loss	**$20,700**

Example #2: Transferring unrealized capital losses to a higher income spouse

Let's take the previous example, but instead of Paul being unable to use the losses, we assume he is in a lower tax bracket. In this example, Paul has unrealized capital losses and could use them to offset his own capital gains but chooses to transfer them to his higher income spouse (Louise) who also has capital gains. We assume that the transfer is completed in the same manner as discussed above, allowing the loss to be claimed by Louise.

Tax savings for the couple

The following calculation shows the approximate tax savings assuming Louise is taxed at a marginal tax rate of 46%[1] and Paul is subject to a marginal tax rate of 20%[1]:

Increase in Paul's taxes as a result of the transfer *(he forfeits the tax savings on the capital loss, which is $90,000 x 50% inclusion rate x 20%[1] tax rate)*	$9,000
Decrease in Louise's taxes as a result of the transfer *($90,000 x 50% inclusion rate x 46%[1] tax rate)*	($20,700)
Total estimated tax savings relating to the transfer of the capital losses	**$11,700**

1) Approximate rate used for the purposes of this example only.

In some cases, it may make sense for you to transfer your unrealized capital losses to your spouse. This strategy could be beneficial where you are not able to use your capital losses, or your spouse is taxed at a higher marginal tax rate allowing you to lower the family's overall tax burden.

Conclusion

In some cases, it may make sense for you to transfer your unrealized capital losses to your spouse. This strategy could be beneficial where you are not able to use your capital losses, or your spouse is taxed at a higher marginal tax rate allowing you to lower the family's overall tax burden.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal, and/or insurance advisor before acting on any of the information in this article.