Reducing taxes by transferring capital losses

Does your spouse have realized capital gains in the current year or the previous three years? Do you have unrealized capital losses? Your spouse may be able to use your capital losses to offset their capital gains, resulting in lower overall taxes for your family.

Simply transferring your investments to your spouse and then having your spouse immediately sell the investments will not work as the Canada Revenue Agency's income attribution rules will re-attribute the loss back to you. However, there is a strategy that may work. This strategy involves selling your investments with unrealized capital losses to your spouse, who can then sell the investments after 30 days to trigger the capital loss.

You should consider this strategy if:

- You own shares with large unrealized capital losses
- You want to sell those shares
- Your spouse has realized capital gains in the current year or the previous three years
- Alternatively, your spouse owns investments with an unrealized capital gain and wishes to sell those investments

KEY BENEFIT

- Maximize after-tax investment returns

Strategy in action

The issue: capital gains tax payable by your spouse

Your spouse has realized (or unrealized) taxable capital gains. You have unrealized capital losses. It's a match made in heaven – at least from a tax planning perspective.

The strategy: transferring capital losses to your spouse

You can transfer your capital losses to your spouse by taking the following steps:

Step 1: You sell your loss securities to your spouse and your spouse pays the fair market value (FMV) for these shares. You can receive cash, property or a loan at the interest rate prescribed by the Canada Revenue Agency (CRA).

Step 2: A transfer of property between spouses is normally treated as a transaction done at the transferor's adjusted cost base (ACB). However, in this case, when filing your annual income tax return for the year of transfer, you elect to have the transfer of these securities take place at their FMV instead of your ACB.

Step 3: Your spouse holds the loss securities for at least 30 days. At this point, the superficial loss rules apply – and you cannot claim the capital loss. This denied loss is added to the ACB of the securities held by your spouse.

Step 4: As a result of the superficial loss rules and the resulting increase in your spouse's ACB (discussed in Step 3), when your spouse then sells the securities on the secondary market after 30 days, your spouse will realize a capital loss for tax purposes (assuming the investment is still in a loss position).

Contact your accountant or tax advisor to understand the tax consequences of the foregoing steps.

The following example illustrates the potential tax savings. For this example, let's assume that your spouse has realized capital gains and you have 10,000 shares with a fair market value of $25,000 and an adjusted cost base of $100,000 (unrealized capital loss of $75,000).

1. You sell the shares to your spouse for $25,000 (FMV).
2. You elect to have the transfer of these securities take place at their FMV instead of your ACB. Your spouse acquires these shares for tax purposes for $25,000 (their ACB becomes $25,000).
3. Your spouse holds the shares for at least 30 days. The superficial loss rules result in the $75,000 loss that you realized on the sale of the shares to your spouse being denied (meaning CRA does not allow you to claim this loss). Because the loss has been denied, your spouse is permitted to add the $75,000 denied loss to their ACB of $25,000. Their ACB becomes $100,000.
4. Your spouse then sells the shares for $25,000 (assuming market value has not changed). When your spouse sells the shares on the market for $25,000, your spouse will realize the capital loss of $75,000.

You		Your spouse	
Shares sold to spouse:		Buys shares from you:	
FMV	$25,000	ACB	$25,000
Less ACB	$100,000		
Capital loss	($75,000)		
		Hold shares for 31 days and superficial loss rules triggered	
Capital loss denied	$75,000	Addition to ACB	$75,000
		Adjusted ACB	$100,000
		Sale of shares on market	
		Proceeds	$25,000
		Less ACB	$100,000
Your capital loss	$0	Spouse's capital loss	$75,000

Result: You have transferred your capital loss to your spouse in order to offset your capital losses against their capital gains. Potential tax savings would be equal to $34,500 (at an assumed 46% marginal tax rate).

PLANNING CONSIDERATION

Please be advised that caution should be exercised in applying this strategy to private company shares.

As with any tax strategy, make sure you also consult with a qualified tax professional before taking action.

Please contact your Investment Advisor and accountant or tax advisor for more information.

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