Reducing taxes by transferring capital gains

Are you about to realize a large taxable capital gain on the sale of securities, such as shares? There may be a way to reduce the tax hit by transferring up to 25% of that gain to your spouse.

Simply transferring the shares to your spouse in order to realize the capital gain will not work due to the income attribution rules. However, there is a strategy that may work. This strategy involves giving half of the shares to your spouse, then selling the other half to your spouse at fair market value. It makes most sense if your spouse is in a lower tax bracket, has unused capital losses carried forward from prior years, or both.

You should consider this strategy if:

- You own shares with large unrealized capital gains
- You want to sell those shares
- You have a spouse who is in a lower tax and/or has unused capital losses

KEY BENEFIT

- Maximize your after-tax investment returns

Strategy in action

The issue: capital gain taxes

You hold securities such as shares that have gained significantly in value and now you want to sell them. Unfortunately, your profit will be reduced by the capital gains taxes, approximately 23% as you are in the top tax bracket.

The strategy: transferring capital gains to your spouse

You may transfer a portion of your capital gain to your spouse, who is in a lower tax bracket, thereby reducing your family's overall taxes.

Step 1: You give half of the shares to your spouse. Under current tax rules, your spouse will acquire the shares at the adjusted cost base (ACB), with no immediate tax consequences to you.

Step 2: You sell the remaining half of the shares to your spouse at fair market value (FMV). You can receive cash, property, or a loan at the interest rate prescribed by the Canada Revenue Agency (CRA). Since you are selling the shares at FMV, you will trigger a taxable capital gain as usual.

Step 3: Your spouse sells all the shares at FMV. As a result of the weighted average cost and income attribution rules, your spouse will realize a portion of the capital gain at their lower tax rate.

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

The following example illustrates the potential tax savings for your family. For this example, assume that you want to sell 100 shares with a FMV of $100,000 and ACB of zero (for simplicity).

Your unrealized capital gain is $100,000, which would trigger taxes of $23,000 at your 46% tax rate.

You give half the shares to your spouse at cost, and sell the remaining 50 shares to them for $50,000 (the FMV). Your spouse then sells all 100 shares for $100,000 at their lower rate of 22%.

You High Income (HI) Spouse		Your spouse Low Income (LI) Spouse	
1. Gift 50% of shares to spouse			
No tax implications		FMV ACB	$50,000 $0
2. Sell remaining 50%			
FMV Less: ACB Capital gain	$50,000 0 $50,000	FMV ACB	$50,000 $50,000
3. Spouse sells 100% of share			
Add: capital gain attributed from (LI) spouse[1]	$25,000	FMV Less ACB *(weighted average)* Less: capital gain attributed to (HI) spouse	$100,000 $50,000 ($25,000)
HI spouse's capital gain	$75,000	LI spouse's capital gain	$25,000
Taxable capital gain (50%) Tax (46%) (A)	$37,500 $17,250	Taxable capital gain (50%) Tax (22%) (B)	$12,500 $2,750
Combined tax: $20,000			

(1) Since 50% of the shares were received as a gift, then 50% of the $50,000 capital gain, or $25,000, is attributed back to you.

Total tax before transfer of capital gains ($100,000 x 50% x 46%)	$23,000
Total tax after implementing transfer of capital gain strategy	$20,000
Minimum tax saving	$3,000
Additional tax saving (with sufficient unused capital losses)	$2,750
Total potential tax savings	$5,750

RESULT: You have transferred 25% of your capital gain to your spouse in order to take advantage of their lower tax bracket and/or unused capital losses.

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

PLANNING CONSIDERATION

Please note that due to a recent court case there may be greater risk in applying this strategy using private company shares.

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

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