Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Tax treatment of in-kind asset transfers

Will the transfer trigger a capital gain or loss?

The Girard Thomson INVESTMENT GROUP of RBC Dominion Securities

Connie Girard
Senior Portfolio Manager
Tel: 403-299-7138
connie.girard@rbc.com

Jeff Thomson, CPA, CA
Portfolio Manager
Tel: 403-299-5230
jeff.thomson@rbc.com

www.girardthomson.ca

On occasion, you may want to transfer an asset in-kind, as opposed to first selling the asset for cash and then transferring the cash. The term in-kind means moving an asset, such as an investment, exactly as is. Sometimes you are able to transfer an asset in-kind at its adjusted cost base (ACB), depending on who you're transferring the asset to. Transfers made at ACB would not trigger any immediate tax implications. Other times, you'll have to transfer an asset at its fair market value (FMV), which may mean you'll realize a taxable capital gain or loss.

This article explores the tax treatment of transferring assets in-kind, whether you're transferring assets between your own accounts, or to another individual. The article also explores transfers between shareholders and their corporations, as well as transfers involving estates and trusts.

This article assumes the assets you're transferring are securities held on account of capital and not property such as real estate or farm property or any other type of asset that may be subject to specific tax rules. It also assumes that the transferee does not own an identical security, otherwise weighted average cost rules may apply.

Any reference to a spouse in this article includes a common-law partner.

Transfers between your own accounts

Between non-registered accounts

When you transfer an asset such as a security between your non-registered accounts, the transfer is generally not a disposition for tax purposes, so there are no immediate tax consequences.

From a non-registered account to a registered account

In some cases, you may want to transfer a security in-kind from

your non-registered account to a registered account of which you are a beneficiary. Registered accounts include a registered retirement savings plan (RRSP), tax-free savings account (TFSA), and registered disability savings plan (RDSP).

Assets in a gain position

If you transfer a security with an unrealized gain from your non-registered account to a registered account, you will realize a capital gain on the transfer. You will need to report the capital gain on your personal income tax return in the year of transfer.

Assets in a loss position

There may be adverse tax consequences if you transfer a security with an unrealized loss from your non-registered account to a registered account. The capital loss is generally denied and you cannot use the loss to offset any other capital gains you may have realized on other transactions.

From a registered account to a non-registered account

It may be possible to make a withdrawal in-kind from a registered account by transferring a security from your registered account directly into your non-registered account. You should check with the financial institution where you hold your account to determine whether in-kind withdrawals are possible.

In some cases, the withdrawals you make from a registered account may be subject to withholding tax. For example, an RRSP withdrawal or a payment from a RRIF that exceeds the minimum payment amount is subject to withholding tax. Part of your in-kind withdrawal may need to be liquidated to satisfy the withholding tax requirement. Keep this in mind when you're determining the amount to withdraw and the securities you choose to withdraw.

The amount of your withdrawal from your registered account will equal the FMV of the security at the time of the withdrawal. The FMV of the security at the time of the transfer will also become the new ACB of the transferred security. The new ACB will be used for determining the capital gain or loss when you dispose of the security in the future.

Transfers made to another individual

In some cases, you may want to transfer a security in-kind to another individual, including your spouse, child or even someone who is not related to you, such as a friend. What's important to know is there are special tax rules that apply to transfers you make to someone who is not dealing at arm's length with you.

> You can generally transfer capital property to your spouse with no immediate tax consequences.

Although the Income Tax Act (ITA) does not contain a precise definition of the term arm's length, it deems some individuals to **not** be dealing at arm's length with each other. For example, related persons are deemed not to deal with each other at arm's length. Related persons are those connected to you by blood, marriage or common-law partnership or adoption, which includes your grandparents, parents, brothers, sisters, children and grandchildren. Your aunts, uncles, nieces, nephews or cousins are not considered to be connected to you by blood for tax purposes, however, they might be considered non-arm's length individuals, depending on the circumstances. Two unrelated individuals are generally considered to be dealing at arm's length with each other if they are independent, and one does not have undue influence over the other.

The next few sections explore the tax implications of transfers you might make to another individual, both arm's length and non-arm's length.

To your spouse

At the time of the transfer

You can generally transfer capital property to your spouse with no immediate tax consequences. This is because the default tax treatment for transfers between spouses is a rollover, which is also known as a spousal rollover. Essentially, the ACB of your security will roll over to your spouse so that your spouse inherits the same ACB of the security. For the rollover to apply, both you and your spouse must be resident in Canada at the time of the transfer.

You are able to elect out of the rollover. If you elect out of the rollover, your proceeds of disposition would be the FMV of the security you transfer. Your spouse's ACB would also then be the FMV of the security on the date of the transfer. The election to have the transfer occur at FMV can be made on a property-by-property basis, meaning that if you transferred 50 shares to your spouse, you could elect to transfer a portion of those shares at FMV — for example, 30 of the shares. There is no specific form required for the election, but the election must be made in your personal income tax return by the return's due date. To make this election, you can attach a letter signed by you and your spouse to your tax return indicating that you don't want the rollover to apply.

If you elect out of the rollover and transfer a security that is in a **gain** position, you would realize a capital gain on the transfer. One common reason to elect out of the rollover is to use any capital losses or capital loss carry-forwards you may have. This strategy can also be useful to make use of otherwise unused credits such as the charitable donation tax credit.

If you elect out of the rollover and transfer a security that is in a **loss** position, you should be aware of the superficial loss rules. Where you transfer a security in a loss position to your spouse, and your spouse continues to hold the security on the 30th day after the transfer, the superficial loss rules will prohibit you from claiming the capital loss. The loss will be denied and added to your spouse's ACB of the security. Although this outcome is generally undesirable, it may present a planning opportunity if your spouse holds other securities in a gain position. For more information on this planning opportunity, please ask your RBC advisor for the article on transferring capital losses to your spouse.

After the transfer

After a transfer to your spouse, whether or not you've elected out of the spousal rollover, any future income, loss, capital gain or capital loss from the transferred property will generally be attributed back to you. This attribution occurs because there are income attribution rules designed to prevent income splitting with your spouse in certain circumstances.

Although the attribution rules apply to income earned on the security transferred, it does not apply to income earned on that income, also known as second generation income. As such, if your spouse reinvests the income earned on the transferred security, the second generation income is not attributed back you and can be taxed in your spouse's hands.

There are exceptions to the attribution rules. For example, if you sell the security to your spouse (instead of gifting it) and your spouse pays you FMV consideration using their own funds, the attribution rules won't apply. For more information regarding the attribution rules, ask your RBC advisor for the article on income splitting and the attribution rules.

To a non-arm's length minor

A non-arm's length minor is someone who is under age 18 throughout the year, and may include your child or grandchild. The following rules also apply to a niece or nephew.

At the time of the transfer

If you gift a security in-kind to a non-arm's length minor, you're deemed to have disposed of the security at FMV.

> When you dispose of a security to a non-arm's length individual, you are generally deemed to dispose of the security for proceeds equal to the FMV on the date of the transfer.

Accordingly, you will realize a capital gain or loss in respect of the transfer. The ACB of the security for the minor will be the FMV of the security on the date of transfer.

After the transfer

After you transfer a security to a non-arm's length minor, any income or loss generated from the transferred security will generally be attributed back to you. This attribution rule does not apply if the minor reaches age 18 before the end of the year. For example, if you transferred shares to your minor child, any interest or dividends paid in respect of the shares now owned by your child will be attributed back to you, unless your child turns age 18 during the year.

The attribution rules, as they apply to minors, only apply to interest and dividend income and do not apply to capital gains and losses. As such, capital gains or losses derived from a subsequent disposition of the security are not generally attributed back to you.

It is generally not possible for a minor to hold an investment account. As such, you may consider establishing a trust for the benefit of the minor in order to facilitate the transfer. It is important that you review your circumstances with a qualified tax and legal advisor before establishing a trust to ensure you understand the tax implications, tax reporting and legal obligations that may arise as a result of creating a trust.

To a non-arm's length adult

At the time of the transfer

When you dispose of a security to a non-arm's length individual, you are generally deemed to dispose of the security for proceeds equal to the FMV on the date of the transfer. This rule applies in many cases, for example, when you gift a security or sell a security to a non-arm's length adult for less than FMV consideration. However, if you receive consideration in excess of the FMV of the property, you're considered to have disposed of the security for proceeds equal to the actual consideration you received. You will need to use the proceeds you received or were deemed to have received to calculate the capital gain or loss on the transfer, which you will need to report on your personal income tax return.

The ACB of the security for the recipient is deemed to be FMV on the date of transfer, if the security was acquired as a gift or if excess consideration was paid. Where there was inadequate consideration paid, the ACB is equal to the actual amount of consideration paid.

Due to these adjustments, the tax consequences may be punitive where you sell a security to a non-arm's length individual for more or less than FMV consideration. For example, assume you bought shares of a corporation for $2,500 which are now worth $10,000. You transferred the shares in-kind to your adult son but only asked him to pay you $6,000 for the shares. The result is that you will have deemed proceeds equal to FMV ($10,000), resulting in a capital gain of $7,500 ($10,000 - $2,500). Your adult child must use the actual amount he paid (i.e., $6,000) as his ACB, so when he disposes of the security in the future, there may be double taxation on a portion of the capital gain.

After the transfer

If you gift a security to a non-arm's length adult, there is no attribution on any type of income. However, if you loan property at low-interest or no-interest to a non-arm's length adult and one of the main reasons for the loan is to reduce your taxable income, any income or loss earned on that property may be attributed back to you. Any capital gain or capital loss realized on that property will not attribute back to you. A loan is considered low-interest where the interest charged on the loan is less than the CRA's prescribed rate.

To an arm's length individual

At the time of the transfer

An arm's length individual generally includes someone who is not related to you and who acts independently from you. When you dispose of a security to an arm's length individual, you generally dispose of it for proceeds equal to the FMV on the date of transfer. You will need to report the capital gain or loss on your personal income tax return. The ACB of the transferred security is the FMV on the date of transfer.

After the transfer

Income attribution does not apply to arm's length transactions. The recipient of the security will pay taxes on all of the future income earned and capital gains realized on the transferred security.

Transfers between shareholders and corporations

From your personal account to a corporate account

Assets in a gain position

When you transfer a security to a corporation where you are a shareholder, the transfer is generally considered a taxable transaction. You will need to report the capital gain on your personal income tax return. The ACB of the security for the corporation will be the FMV on the date of the transfer.

> When you transfer a security to a corporation where you are a shareholder, the transfer is generally considered a taxable transaction.

If you do not want to realize a capital gain on the transfer, you may be able to transfer the security on a tax-deferred basis by filing a joint income tax election with the corporation. This election allows you to transfer the security to your corporation at an elected amount that's between the security's ACB and FMV (subject to certain conditions). By choosing an elected amount that's equal to the ACB of the security, you will not realize a capital gain on the transfer. The corporation will be considered to have acquired the security at the elected amount as well. Note that this joint tax election is generally not available for assets in a loss position.

Assets in a loss position

There are superficial loss rules that prohibit you from claiming a capital loss when you transfer a security to a corporation that's controlled by you or someone affiliated with you, such as your spouse. If the superficial loss rules apply, your capital loss is denied.

The ACB of the security for the corporation is the FMV of the security on the date of transfer plus the denied loss. As such, when the corporation eventually disposes of the security to a non-affiliated person, it will realize a smaller capital gain or larger capital loss due to the increased ACB. This may present a planning opportunity if your corporation has capital gains. For more information, please ask your RBC advisor for an article on transferring securities in a loss position to and from your corporation.

From a corporate account to your personal account

You may or may not be subject to tax when you transfer an asset from your corporation to you personally. The personal tax treatment of the transfer depends on the corporate tax structure, the corporation's tax attributes as well as your personal tax situation. You should consult with a qualified tax advisor to understand the personal tax implications of such a transfer. The following discusses the tax implications of an in-kind asset transfer from the corporation's perspective only.

Assets in a gain position

When a corporation transfers securities to you, the corporation will realize a disposition at FMV and will need to report the capital gain on its corporate income tax return. The ACB of the securities you receive will be the FMV of the securities on the date of the transfer.

Assets in a loss position

If you're a controlling shareholder, there are stop-loss rules that apply when the corporation transfers a security in a loss position to you or someone affiliated with you, such as your spouse, and you or the affiliated person continues to hold that security on the 30th calendar day after the transfer. In general, these rules defer the recognition of a realized loss. If the stop-loss rules apply, the loss is suspended (unavailable for use) in the corporation until the time you or the affiliated person disposes of the security to a non-affiliated party. The ACB of the security you receive will be the FMV of the security on the date of the transfer. For more information on the stop-loss rules, please ask your RBC advisor for an article on transferring securities in a loss position to and from your corporation.

From a corporate account to another corporate account

In some cases, you may want to transfer a security in-kind from one corporation controlled by you (Corporation A) to another corporation controlled by you (Corporation B).

Assets in a gain position

If the security is in a gain position, the transfer is generally a taxable transaction. Corporation A will need to report the capital gain on its corporate income tax return. The ACB of the security for Corporation B will be the FMV of the security on the date of the transfer.

If Corporation A doesn't want to realize the capital gain on the transfer, it may be able to transfer the security on a tax-deferred basis by filing a joint income tax election with Corporation B. This election allows Corporation A to transfer the security to Corporation B at an elected amount that's between the security's ACB and FMV (subject to certain conditions). By choosing an elected amount that's equal to the ACB of the security, Corporation A will not realize a capital gain on the transfer.

One aspect to note is that by making this election, Corporation A will need to take back at least one share of Corporation B, which may change the organizational structure of your holdings and may not be what you intended.

Assets in a loss position

The stop-loss rules may apply if Corporation A transfers a security in a loss position to Corporation B and Corporation B holds the security on the 30th calendar day after the transfer. In general, these rules defer the recognition of a realized loss. If the stop-loss rules apply, the loss is suspended (unavailable for use) in Corporation A until the time Corporation B disposes of the security to a non-affiliated party. At that time, Corporation A will realize the loss. The ACB of the security for Corporation B will be the FMV of the security on the date of the transfer.

An inter-vivos trust, also known as a living trust, is a trust created during a person's lifetime. When you, the settlor of an inter-vivos trust, contribute a security to a trust during your lifetime, the transfer is generally a taxable transaction.

Transfers involving estates or trusts

Contribution by the settlor to an inter-vivos trust

An inter-vivos trust, also known as a living trust, is a trust created during a person's lifetime. When you, the settlor of an inter-vivos trust, contribute a security to a trust during your lifetime, the transfer is generally a taxable transaction. You may need to report a capital gain or loss on your personal income tax return. The ACB of the security for the trust is equal to the FMV on the date of the transfer.

If you are the settlor and you and/or your spouse are a majority interest beneficiary of the trust and the assets you're contributing are in a loss position, the superficial loss rules may apply. If the superficial loss rules apply, your capital loss is denied. The ACB of the security for the trust in this case is the FMV of the security on the date of transfer plus the denied loss. As such, when the trust eventually disposes of the security, it will realize a smaller capital gain or larger capital loss due to the increased ACB. For more information, please ask your RBC advisor for an article on the superficial loss rules.

There are exceptions to these rules when you're contributing a security to certain types of trusts, including a spousal trust, alter ego trust or joint spousal trust. You can generally choose to transfer a security to these types of trusts at your ACB so you don't trigger a capital gain or loss.

From the deceased to an estate account or testamentary trust

In general, on death, you are deemed to dispose of your securities at FMV. The executor/liquidator of your estate will need to report the capital gain or loss realized on your final personal income tax return. When a security is transferred to your estate account or to a testamentary

trust, the transfer occurs at the date-of-death value of the securities. This value also becomes the ACB of the securities for the estate or trust. There is an exception to this general rule where you transfer a security to your surviving spouse or to a qualified testamentary spousal trust. In this case, the security can be transferred to the surviving spouse or testamentary spousal trust at your ACB so that a capital gain or loss is deferred until the security is disposed of.

Distribution from a trust to a beneficiary

When capital is distributed from a trust in-kind to a Canadian resident beneficiary, the distribution can be received by the beneficiary tax-free. Generally, the trust does not realize a capital gain or loss on the distribution and the beneficiary assumes the ACB of the assets from the trust.

This is the case unless the super attribution rules applied to the trust at any time. The super attribution rules generally apply when the settlor or contributor to a trust can take back the assets they've contributed to the trust or can control the distribution of the assets from the trust. If the super attribution rules apply, the capital will generally need to be distributed to a beneficiary at FMV, unless the beneficiary is the contributor to the trust or the contributor's spouse, or if the contributor has passed away. Capital distributions to a non-resident beneficiary must also be done at FMV, triggering a taxable disposition in the trust.

In cases where the tax-deferred rollover is available, the trust and the beneficiary can choose to instead transfer the assets out of the trust to the beneficiary at FMV. The beneficiary's ACB of the assets will then be equal to the FMV of the assets on the date of the transfer, and the trust will report the disposition on its trust tax return. It may make sense to trigger capital gains in the trust where the trust has unused capital losses.

Conclusion

Understanding the tax implications of transferring assets in-kind may help you plan for any potential capital gains tax or help you avoid transactions that could trigger the superficial loss rules. There may also be tax consequences following a transfer, such as attribution, so it's important to speak with a qualified tax advisor to understand the tax implications of the specific transfer you're planning to make.

This article may contain 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.

Wealth Management

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. ®/™ Registered trademarks of Royal Bank of Canada. Used under licence. © 2022 Royal Bank of Canada. All rights reserved. NAV0158 (01/22)