RBC Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Aaron Fennell, MBA, CFA
Portfolio Manager & Investment Advisor
Tel: 416-313-6397
aaron.fennell@rbc.com

RBC Dominion Securities
181 Bay Street, Suite 2350
Toronto, ON M5J 2T3
www.aaronwfennell.com

Transferring capital losses to your spouse

Do you have unrealized capital losses that have accrued on your investments that you're unable to use personally? Does your spouse have taxable capital gains that would be subject to tax? If so, you may want to consider transferring your unrealized capital losses to your spouse. 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. If your spouse has unrealized capital losses and you have taxable capital gains, your spouse may be able to transfer those losses to you in the same manner.

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

Capital gains and losses

You realize a capital gain when you sell capital property and the proceeds you receive exceed the adjusted cost base (ACB) of that property. Conversely, you realize a capital loss when you sell capital property and the proceeds are less than the ACB of the property.

If you realize more capital gains than capital losses in a year, 50% of the difference is taxable to you. If, instead, you realize more capital losses than capital gains in a year, you may be able to carry back the excess losses to offset capital gains you realized in any three preceding years or carry forward the excess losses to offset capital gains you realize in the future.

An important point to note is that capital losses can generally only be used to offset capital gains realized by the same person. As such, if you have unrealized capital losses that you're unable to use personally, and your spouse has 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 still want to transfer these capital losses to your spouse if your spouse is in a higher marginal income tax bracket and has capital gains that would otherwise be subject to tax at a higher rate.

A simple share transfer does not work

If you simply transfer the securities that are in a loss position to your spouse, the income attribution rules will prevent the loss from being realized in your spouse's hands. 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.

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

- You sell the securities at FMV to your spouse and your spouse pays you full consideration 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 (e.g. on the market) to realize the loss. You would need to report the sale on your tax return.

Using this strategy will trigger the superficial loss rules. The superficial loss 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 can't claim the capital loss. The amount of the capital loss is not lost but rather added to the ACB of the securities you sold, which now belong to your spouse. Once your spouse sells the securities to a third party, they will realize the loss.

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Examples of potential tax savings

Example 1: Transferring unrealized capital losses to a spouse that has capital gains

Paul currently owns securities with an ACB of $100,000 and a FMV of $10,000. As such, he has an unrealized capital loss of $90,000. He wants to sell the security, but he would not be able to use the capital loss. Unfortunately, he's had a spell of losses for the past few years and is doubtful about realizing a capital gain any time soon. Paul's spouse, Louise, chose to invest in a different basket of securities and has realized capital gains almost every year. This year alone, she has already realized 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 realized capital gains.

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

After the sale, 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 the objective of this strategy will be missed.

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

To realize a loss, Louise will need to sell these 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 realized capital loss can be used by Louise to offset her realized capital gains.

Tax savings for the couple

The following calculations show the approximate tax savings of this strategy, assuming Louise is subject to a marginal tax rate of 46% and Paul can't personally use the capital loss:

Increase in Paul's taxes as a result of the transfer	$0
Decrease in Louise's taxes as a result of the transfer ($90,000 x 50% inclusion rate x 46% tax rate)	($20,700)
Total tax savings relating to the transfer 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's in a lower tax bracket than Louise. 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. Let's assume the transfer is completed in the same manner as the previous example, allowing the loss to be claimed by Louise.

Tax savings for the couple

The following calculations show the approximate tax savings of this strategy, assuming Louise is subject to a marginal tax rate of 46% and Paul is subject to a marginal tax rate of 20%:

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% tax rate)	$9,000
Decrease in Louise's taxes as a result of the transfer ($90,000 x 50% inclusion rate x 46% tax rate)	($20,700)
Total estimated tax savings relating to the transfer of the capital loss	**$11,700**

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're not able to use your capital losses or your spouse is taxed at a higher marginal tax rate, allowing you to lower your family's overall tax burden. It's important you consult with your qualified tax advisor prior to implementing this strategy to determine if it would benefit you and your family.

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.

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