The Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Wealth Management

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Transferring future growth of a security to your spouse

Examining a potential option to transfer the future appreciation of a security to your spouse without triggering the income attribution rule

If you hold a security, such as a stock, that you expect will significantly increase in value and you'd like to have its future appreciation taxed in the hands of your spouse rather than in yours, this article discusses a potential tax planning approach that may help you achieve this without triggering the income attribution rules.

Why might you transfer an appreciating security to your spouse?

You want to achieve income splitting with your lower-income spouse

Income splitting is a tax-saving strategy available within Canada's progressive tax system (i.e. the more income you earn, the higher your marginal tax rate), making it possible to shift income from a family member who's taxed at a higher marginal tax rate to one who's taxed at a lower marginal rate. If you have a lower-income spouse, you may be able to transfer a security you currently own and that you anticipate will increase in value to your spouse in order to have any future capital gain taxed in your lower-income spouse's hands.

If you simply gift the security to your spouse, however, any first-generation investment income earned on the security and the future capital gain will be subject to the attribution rules. If these rules apply, the income and capital gains will be attributed back to you and taxable to you for income tax purposes. To avoid triggering the income attribution rules, the transfer needs to take place in a particular way, which we discuss later on in the article.

Your spouse has unused capital losses but no capital gains

If your spouse has carried forward capital losses, it may be beneficial to transfer a security you anticipate will appreciate in value to your spouse. By doing so, this may allow their unused capital losses to offset any future capital gains from the transferred security, which could potentially result in a tax-free capital gain.

Provided your spouse purchases the security for the fair market value (FMV) with their own money, you will not trigger the attribution rules, and any future capital gain (or loss) will be taxable in your spouse's hands.

Transferring the security

There are three common ways you can transfer the security to your spouse while ensuring you do not trigger the attribution rules.

You sell your security on the open market and your spouse purchases the same security with their own funds.

Provided your spouse purchases the security for the fair market value (FMV) with their own money, you will not trigger the attribution rules, and any future capital gain (or loss) will be taxable in your spouse's hands.

Transfer the security to your spouse "in-kind" for the fair market value.

Instead of you selling the security on the open market and then your spouse purchasing the same security, you may consider transferring the security to your spouse "in-kind" (i.e. transferring the actual security). To avoid triggering the attribution rules, your spouse will need to pay you FMV for the security, using their own funds. Keep in mind that you are selling the security so you will realize any capital gain on the transfer. The cost base of the security received by your spouse will generally be the FMV of the security on the date of transfer.

When considering this method, please consult with an RBC advisor about how to best accommodate your request from an administrative standpoint. There could also be additional tax preparation fees since you have to file an election with your income tax return to transfer the security to your spouse at FMV.

Lend cash to your spouse to fund their purchase of the same security.

If your spouse isn't able to purchase your security with their own money, consider lending them the funds or taking back a note at the Canada Revenue Agency (CRA) prescribed rate to ensure that the income attribution rules don't apply. With this approach, the security would be sold on the open market and the associated capital gain reported in the year of sale. You would lend cash to your spouse at the CRA prescribed rate and the spouse would use these funds to purchase the same security on the open market. Alternatively, you could sell the security to your spouse and take a note that charges the CRA prescribed rate as consideration.

When considering this method, you will want to take into account the tax impact of using a prescribed rate loan. Your spouse will be able to deduct the interest they pay you, and you have to include the interest you earn on the loan in your income for tax purposes. Depending on the circumstances, using this method may be less tax-effective than your spouse purchasing the security with their own money.

The borrowing spouse would pay interest on the loan at the prescribed rate by January 30 of each year and deduct the interest on their tax return. You would report the interest income received annually on your tax return.

Special considerations

Attribution rules

When implementing this strategy, it's important to ensure that the transaction doesn't trigger the income attribution rules. This can be achieved by ensuring your spouse pays FMV for the security. If the attribution rules are triggered, you'll be required to report any future appreciation (i.e. capital gain) and income on your tax return, even if your spouse is holding the security in their own name.

Superficial loss rules (if securities are in a loss position)

If your securities are currently in a loss position but you'd like to transfer them to your spouse based on your expectation that they'll increase in value in the future, it's important to be aware of the superficial loss rules. If your sale of the security and the

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subsequent purchase of the same security by your spouse triggers the superficial loss rules, you won't be able to use the capital loss on the sale of your security. Instead, your loss will be added to the cost base of the identical security that your spouse purchased, and this may defeat the purpose of the strategy.

To avoid triggering the superficial loss rules, your spouse needs to wait 30 days from the settlement date on which you sell your security before they repurchase the same security. If you transfer the security in-kind to your spouse, your spouse would need to dispose so that they do not own the security on the 30th day after the transfer. Please ask an RBC advisor for an article for more information on the superficial loss rules.

Conclusion

If you hold a security you expect is going to appreciate significantly in value, you may benefit from transferring it to your spouse, if your spouse is in a lower tax bracket or if they have unused capital losses. The approach you choose to transfer the security — and whether it may be beneficial or not — will depend on your situation and whether your spouse has their own funds to facilitate the transaction. With this in mind, it's important to seek advice from a qualified tax advisor with respect to your personal situation.

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.

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