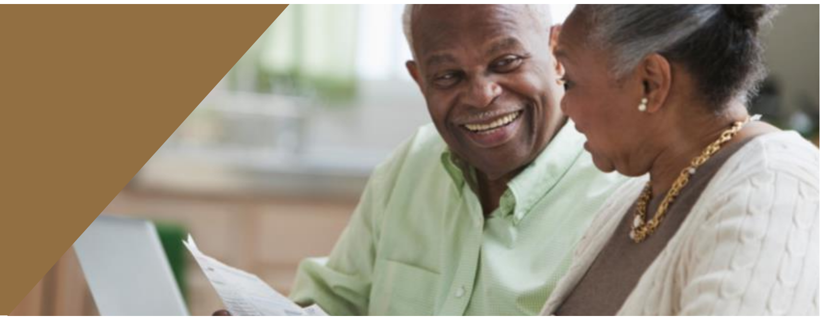
In-kind transfers



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Some Canadians are choosing to gift to their beneficiaries now while they are living instead of leaving the assets to them in their will. Gifting can be a very powerful estate planning tool but both tax and non-tax considerations should be carefully examined to avoid any negative consequences.

- For tax purposes, there are potential capital gains implications upon gifting and associated attribution rules on income generated from the gifted assets
- Gifting can be an effective tool to minimize probate taxes
- Special rules apply to joint ownerships
- Consider all legal and personal implications before making the gift

Income tax considerations

For tax purposes, a gift of assets is deemed to be a sale of the asset at fair market value ("FMV") even though no consideration is received. Assets can be gifted to a spouse, a child or someone who is not related to you. Depending on the recipient, there may be different tax implications at the time of transfer and after the time of transfer.

Gifts to a spouse / common-law partner

- Generally, when assets are transferred between spouses, there are no tax implications as the receiving spouse will receive the property at the same adjusted cost base but any potential capital gain, when eventually sold to a third party, will be attributed back to the grantor (the person doing the gifting). You and your spouse will have the option of electing to transfer the asset at FMV. If there is any immediate capital gain resulting from the transaction, it will have to be reported on the grantor's tax return, any future capital gains will be taxed in the grantor's hands unless FMV consideration is received.
- If the asset is in a loss position and the receiving spouse holds the security for more than 30 days, the loss would be considered a superficial loss which means the grantor would not be entitled to claim the capital loss.

Gifts to non-arm's length adult individuals

- Transfers to non-arm's length adult individuals (including adult children, parents, brothers, sisters, nieces and nephews, etc.) will deem the assets being disposed at FMV. Any gains (losses) resulting from the transfer will be reported on the grantor's tax return. A common probate minimization technique is to add an adult child's name on the asset with the right of survivorship[1]. The Canada Revenue Agency will consider this as a disposition and any capital gains resulting would be reported on your personal income tax return creating unintended tax consequence for the grantor.

[1] Individuals should seek independent legal advice on assets held in joint ownerships as it relates to joint liability and effective transfer of ownership under current trust and estate laws

- *If the transfer was an outright gift*: then any future investment income and any capital gains (losses) will be taxable in the hands of the recipient.
- *If the asset was loaned to the individual that charges less than the prescribed rate of interest*, then any investment income (loss) would be attributed back to the grantor. In this case, capital gains (losses) that arise after the transfer would not be attributed back to the grantor.
- It is worth noting that negative tax consequences can arise when consideration is less than FMV. First, the grantor would be deemed to have disposed the assets at FMV and any capital gains will be immediately taxed in the grantor's hand. Second, the recipient would be deemed to have acquired the asset at the amount of consideration given. When they eventually sell the assets, there will be double taxation on the difference between the FMV and actual consideration paid.

Gifts to a minor child

- Transfers to a minor child (including your child, minor grandchildren, minor niece or nephew or any non-arm's length minor, etc.) will deem the assets to be disposed of at FMV. Any gains (losses) resulting from the transfer will be reported on the grantor's tax return.
- After the transfer, any resulting investment income (loss) will be taxed in the grantor's hands. However, any capital gains (losses) will be taxed in the hands of the minor and will not be attributed back to the grantor.

Gifts to arm's length adult individuals

- Similar to gifts to a minor child, transfers to arm's length adult individuals (anyone who is not related by blood or legally adopted) will deem the assets to be disposed of at FMV. Any gains (losses) resulting from the transfer will be reported on the grantor's tax return. The difference between gifting to a minor child and an arm's length adult is that both investment income (loss) and capital gains (losses) after the transfer will be taxed in the hands of the recipient and the attribution rules would not apply.

	Gift to spouse		Gift to adult child	Gift to minor child	Gift to arm's length individual
Deemed disposition	Adjusted cost base	Fair market value (with elections)	Fair market value	Fair market value	Fair market value
Cost base of recipient	Adjusted cost base	Fair market value (with elections)	Fair market value	Fair market value	Fair market value
Future income (losses)	Taxable to the gifting spouse	Taxable to the recipient spouse*	Taxable to the recipient	Taxable to the grantor	Taxable to the recipient
Future capital gains (losses)	Taxable to the gifting spouse	Taxable to the recipient spouse*	Taxable to the recipient	Taxable to the recipient	Taxable to the recipient

* Based on gifting spouse receiving fair market value consideration

Other considerations

While inter-vivos gifting can be an effective tax and probate minimizing tool, individuals should thoroughly understand and assess other considerations to ensure this is the right strategy for you.

Your own financial situation

Before considering any gift of assets to your heirs or other future intended beneficiaries, you must first assess your own financial situation. You must account for all your assets and sources of income to determine if you have enough assets to maintain the standard of living and required care during your lifetime. If there are insufficient assets to maintain your standard of living, it may not be a good time to make a gift.

Loss of control

Once legal ownership of assets is transferred, you would lose control over the possession and use of the property. The property could be sold or used without your discretion and against your wishes. If the individual wants to maintain some degree of control over the asset, an outright gift may not be the best choice. The individual may consider establishing a trust to hold the asset.

Property Transfer Tax ("PTT")

If the property to be gifted is real property, the transfer of title to the individual may be subject to PTT. PTT is based on the fair market value of the real property transferred. In provinces such as British Columbia and Ontario, depending on the value of the real property, PTT may be upwards of 3% (whereas probate fees are 1.5%).

Exposure of assets to creditors and ex-spouses

Once an asset is gifted to an individual, the asset would be exposed to the individual's creditors and spouses in the event of a marital breakdown. If a creditor obtains judgement against the individual, the asset that was gifted would now be subject to the creditor's claim. If the claim is large enough, the asset would have to be sold in order to satisfy the creditors claim. Similarly, in a marital breakdown, the asset may be deemed to be a "family asset" and would be subject to division. Both may be unintended consequences of gifting assets during an individual's lifetime.

Summary

Gifting during your lifetime can be a balancing act between probate fees, income taxes, life expectancy, standard of living and future care costs. To provide clarity, individuals may consider a deed of gift where the terms and conditions of the gift are clearly laid out for the grantor and the recipient. Individuals are strongly advised to speak with their own legal and tax advisors regarding their own unique situations before making any gifts.