THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

# Give the gift of tax savings to your spouse

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You'd think that after 23 years of marriage I'd get the gift-giving process right. I made a terrible mistake again last month. It was Carolyn's birthday and she made me promise that I wouldn't give her anything fancy. So – I didn't. I should have known better. Fortunately, Christmas is coming and I have a chance to redeem myself. This year, I'm going to give her the gift of tax savings. I think she'll like that – maybe more than earrings.

If you want to provide your spouse with tax savings this year, you may be able to do this by transferring unrealized capital losses to your spouse. This could make sense if you have unrealized capital losses and no capital gains to offset those losses, but your spouse has capital gains.

I've written about this idea before in the context of publicly traded securities. But what if you own an asset that has declined in value and doesn't trade on the stock market? The idea can still work.

## THE SCENARIO

Consider Jack and his wife, Jill. Jack owns shares of XYZ Corp., which no longer trade on the stock market. Jack had paid $10,100 for the shares, but they're worth just $100 today (the company is insolvent). While Jack could claim a $10,000 capital loss on his XYZ shares by simply electing to claim the loss (subsection 50(1) of our tax law allows this when certain conditions are met), the fact is that Jack can't benefit today from this loss because he has no capital gains to use up these capital losses.

Jill, on the other hand, reported some capital gains in 2019 and could use the capital losses to offset those capital gains. You might recall that capital losses can be carried back up to three years if they can't be used to offset capital gains in the current year.

## THE STEPS

There are three steps to transferring the capital loss from Jack to Jill.

Step 1: Jack is going to sell his XYZ shares to Jill. In this case, Jack is going to arrange with his brokerage firm to transfer the shares to an account in Jill's name. The couple should draw up a simple purchase and sale agreement, and Jill should actually pay Jack the $100 market value of the shares (in cash or a promissory note bearing interest at the prescribed rate in effect at the time of the sale).

But there's an issue. The superficial loss rules in our tax law won't allow you to realize a capital loss by selling to your spouse. So Jack won't be able to claim his $10,000 capital loss. The loss, however, isn't gone forever. You see, the $10,000 loss denied to Jack will be added to Jill's cost amount so that, eventually when she sells the shares, she'll have a smaller capital gain or larger capital loss at that time. So, while Jill paid just $100 for the shares, this cost is bumped up by the $10,000 capital loss denied to Jack, giving her a total cost, or adjusted cost base (ACB), of $10,100.

Step 2: Jill is going to sell the XYZ shares. Jill now owns the XYZ shares with a value of $100, but an ACB of $10,100. She can now sell the XYZ shares and will realize a $10,000 capital loss in the process. She could sell the shares on the open market if the company begins trading again. Alternatively, she could sell the shares to a friend or family member (but not Jack) for their current value of $100. Or she could simply elect to claim the loss on her tax return (thanks to subsection 50(1), which I talked about earlier).

Step 3: Jack will file an election with his tax return. It's important that the sale to Jill take place at fair market value for the strategy to work. Otherwise, any capital loss realized by Jill will be attributed back to Jack under the attribution rules in our tax law. In order for the transfer to take place at fair market value, Jack needs to file an election (a statement attached to his tax return) that says he elects that the provisions of subsection 73(1) of the Income Tax Act not apply on the transfer of shares to Jill. Subsection 73(1) causes any transfers between spouses to automatically take place at cost amount – which we don't want.

## THE NUANCES

Although Jack transferred XYZ shares to Jill, you can transfer many types of assets, including real estate or private company shares. Personal use property (PUP), such as cars or a home, won't work however, because capital losses on PUP cannot be claimed.

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