CESTNICK

TAX MATTERS

Your investment loss could be your spouse's tax gain

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED NOVEMBER 1, 2023

You might have heard of the Darwin Awards. The awards, created by author Wendy Northcutt, are given to people who die in such an idiotic manner that their action ensures the long-term survival of the species, by selectively allowing one less idiot to survive. Maybe not surprisingly, a study a few years ago showed that 88.7 per cent of people receiving a Darwin Award are men.

This doesn't surprise my wife in the least. Last weekend she got angry at me for breaking a window at our home when I decided to install some Christmas lights by stacking two ladders on top of each other to reach above our kitchen window. I told her I'd make it up to her. I'm going to put some money in her pocket through some clever tax planning. "No need to thank me," I said to her. Here's the idea I've got in mind.

The Concept

Suppose you have an investment in your portfolio that has declined in value. You still own it, so you have an unrealized capital loss. You could take advantage of this loss by selling the investment and then applying the capital loss against capital gains. Our tax law will only allow use of those capital losses by applying them against capital gains – not other income.

Now, suppose you don't have capital gains to offset the capital losses. But let's assume your spouse has capital gains. There's a way to transfer those capital losses to your spouse so that they can offset the gains. This can allow your spouse to save tax on the capital gains and could even allow your spouse to recover taxes that might have been paid in one of the past three years.

The story

I first used this idea many years ago when a gentleman, named Peter, came to me with a problem. He had purchased shares in Bre-X Minerals Ltd., the former gold mining company – and so had his wife, Wendy. As it turns out, Wendy had sold her Bre-X Minerals Ltd. shares for a profit of $400,000. She was smart and exited her position before it was discovered that the company's gold resource at Busang, Indonesia, was a massive fraud.

Unfortunately, Peter kept his Bre-X Minerals Ltd. shares too long and ended

up losing about $400,000 of his money. But he couldn't use the capital losses because he had no capital gains. He came to me looking for a way to apply his losses against Wendy's gains. We were able to help by outlining three steps to take to transfer his capital losses to Wendy for her to use.

Step 1: Peter sold his Bre-X Minerals Ltd. shares on the open market. At the time, the shares were still trading, so he was able to sell the shares for $10,000 and realized a $400,000 capital loss in the process. But since he couldn't use the losses, we didn't stop there.

Step 2: Wendy then purchased the same number of Bre-X Minerals Ltd. shares on the open market as Peter had just sold, for the same price of $10,000. When Wendy purchased the shares, the superficial loss rules kicked in and denied Peter the ability to use his $400,000 capital loss. Those rules say that when you sell a security at a loss, and then you, or someone affiliated with you (like your spouse), purchases the same security within a time frame that is 30 days before or after the sale, then your loss will be denied.

So, Peter's capital loss was denied. But it didn't disappear forever. Our tax law will cause the loss that is denied to be added to the adjusted cost base (ACB) of the newly acquired securities. The reason? So that the eventual sale of the newly acquired securities will give rise to a smaller capital gain or a larger capital loss. So, the $400,000 loss denied to Peter was added to Wendy's $10,000 cost amount, resulting in a total ACB for her of $410,000.

Step 3: Wendy then sold her Bre-X Minerals Ltd. shares for their true value of $10,000. In this case, the stock had ceased trading, so she sold her shares to an adult family member (not Peter) by drafting up a simple purchase and sale agreement. If Bre-X Minerals Ltd. had still been trading, she could have simply sold the shares on the open market.

The nuances

The timing of these steps matters. Step 1 (the initial sale) starts a 30-day clock ticking. Step 2 (the repurchase) must take place before the 30th day after Step 1. That means the "superficial loss" rules kicks in, which would deny Peter's losses and will enable the loss to be transferred to Wendy. Then, Step 3 (the second sale, which is made by Wendy) must take place after the 30th day following Step 1. If you don't respect this timing, the superficial loss rules may not apply. In this event, Peter in our story may have had the capital loss without it transferring to Wendy. Finally, initiate Step 1 before Nov. 25, 2023, to make sure that Step 3 takes place in 2023 if you like this idea and want to have the capital loss available this year.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca