



CESTNICK

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TAX MATTERS

# A primer on how to lend money to your kids properly

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When I was 15 years old I recall asking my father if I could borrow \$50. “Fifty bucks? What do you need 20 bucks for?” he replied. “I only have 10. Here, have five.” Little did he know that I really only needed five bucks. I knew how to play the game.

Today, more than ever, parents are stepping up to help kids financially if they can. The cost of living has skyrocketed. Groceries and rent are over 25 per cent more expensive today than they were five years ago. And buying a home is out of reach for many young people. If you’re a parent or grandparent thinking of lending money to a child, here’s a primer on what to consider.

**Loans for personal use:** If you lend money to a child or grandchild to buy a principal residence, cover education costs, build a deck, buy a laptop, or for any other non-income-producing purpose, there are no tax issues to worry about (unless you’re selling investments to free up cash to lend, in which case you might have tax to pay on those dispositions).

**Loans for business or appreciating assets:** If you lend money to a child to invest in a business (or lend directly to a child’s corporation), or to purchase appreciating assets (i.e. to realize capital gains), there’s generally no tax issues to be concerned about.

**Loans to earn income from property:** If you lend money to an adult child to earn income from property – which includes interest, dividends, rents or royalties – your child will generally pay the tax on that income. The exception? If the taxman concludes that one of the main reasons for the loan was to allow you to avoid tax, the attribution rules could apply to tax you on the income instead. It could be tough for the taxman to prove that your intention was to avoid tax, but you can prevent a battle by charging the what the CRA calls the prescribed rate of interest (currently 5 per cent) on this type of loan – if you want.

**Loans to minors:** A minor is not able to enter a loan agreement, so if you want to lend money to a minor you’ll have to make the loan to a trust for your child. Nevertheless, any income from property

earned will be attributed back to you and taxed in your hands (unless you charge the prescribed rate on the loan). Any capital gains realized will be taxed in the hands of your child, or the trust.

Loans for TFSA contributions: Under our tax law, only the tax-free savings account holder can contribute to their TFSA. So, you can't contribute to their plan as a parent or grandparent – although you can lend money interest-free to the child to make contributions. It's important that your child alone have all rights related to the amount and timing of withdrawals, and the investment of the funds in the TFSA. If you try to control any of these things by virtue of your loan, the taxman could refuse TFSA status for the account. You can also gift money to your child for contributions to avoid these issues.

Loans for probate avoidance: Some people will lend money to their kids with the hope of avoiding probate fees at the time of death on the lent funds. Don't forget, however, that a loan owed to you at the time of your death is still an asset of yours, which could be subject to probate fees if your province or territory levies this type of tax. You may be able to avoid these fees by using a separate will to deal with the loan owing to you, perhaps along with certain other assets such as private company shares. Speak to a lawyer in your province about this.

Loans to protect assets: If you're concerned about a child being subject to the claims of creditors or ex-spouses, lending money to them and securing the loan with assets of your child (a mortgage on their home, for example) can help to protect those assets from other claims.

Loans can be forgiven: If your child owes you money, you can forgive any loans at the time of your death without any negative tax consequences. You might include a "hotchpot clause" in your will which causes the loan to be treated as an advance on a child's inheritance, equalizing inheritances among your beneficiaries when you're gone.

I'll share more on this topic next week.

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