THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Transfer Capital Losses to Your Spouse to Save Tax

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Carolyn and I have been married for 22 years now. We've been looking for things to do together to "reconnect." She hasn't liked my ideas so far. I had suggested participating in a competition for spouses that I've heard of. In the competition, one team member carries the other, in any way you prefer, for a distance of about 400 metres through an obstacle course, and the first team to cross the finish line wins. The world championships are held in Finland every year. Carolyn said "no" to this – probably because I'm not as fit as I was a few years ago, which would make me very heavy to carry.

So instead, I suggested a quiet evening at home – just the two of us – talking. Specifically, talking about how we can save tax as a couple. Again, she said "no." Too bad, I had a great idea I wanted to share with her – which I'm going to share with you today. It involves transferring capital losses from one spouse to the other to save taxes.

THE IDEA

Take a look at your investment portfolio. Do you have any investments that have declined in value? Our tax law will allow you to deduct your realized capital losses against capital gains you might have realized this year, or in one of the previous three years.

What if you don't have sufficient capital gains to offset those losses? You can always carry those losses forward indefinitely for use in a future year. But it's also possible to transfer unrealized losses (losses on paper) to your spouse or common-law partner if they have capital gains that could be sheltered from tax. It can make sense to use up those losses sooner rather than later.

THE EXAMPLE

Consider Jack and Jessica. Jack owns shares in XYZ Corp. with a cost amount of $50,000, but are worth just $30,000 today, for an unrealized capital loss of $20,000. Suppose also that Jack doesn't have any capital gains this year, or in the past three years. Jessica, however, had reported a capital gain of $20,000 in 2018 and paid taxes of about $5,000 on that gain last year.

If Jack could transfer this $20,000 of unrealized capital losses to Jessica, she could then take those losses and carry them back to 2018 and recover the taxes that she paid. There are three steps to make this happen.

Step 1: Jack is going to sell his XYZ shares on the open market, which will trigger a $20,000 capital loss in his hands. Since Jack doesn't have any capital gains, he can't use those losses, so we won't stop at this step.

Step 2: Jessica will then acquire the same number and type of XYZ shares on the open market immediately after Jack sells his shares. Two things will happen: First, Jack's $20,000 capital loss will be denied. How so? The "superficial loss rules" in our tax law won't allow you to claim a capital loss if you, or someone affiliated with you (your spouse, for example), acquires identical property with a certain time frame (30 days prior to and 30 days after your sale of the property – a 61-day window in total).

The second result is that Jessica's adjusted cost base (ACB) is bumped up. You see, when Jack's capital loss is denied, that loss is now added to the cost amount that Jessica paid for her XYZ shares. So, Jessica will purchase the XYZ shares for $30,000, but the $20,000 capital loss that was denied to Jack is added to her ACB, so that her cost for tax purposes is now $50,000. Why is this done? Because the taxman won't deny Jack's capital loss forever; the taxman is willing to allow a claim for that loss eventually. It's added to the ACB of the newly acquired shares (which happen to be owned by Jessica) so that when these new shares are sold, there will be a smaller capital gain, or a larger capital loss on that sale.

Step 3: Jessica is going to wait until the 61-day superficial loss window is over, then she'll sell her XYZ shares on the open market. Don't forget that Jessica's ACB is $50,000, so if she sells for the fair market value of about $30,000, she'll have a realized capital loss of $20,000 that she can now use.

Jessica can carry that loss back to 2018 to recover the taxes she paid on her capital gain last year. There's still time to use this idea in 2019. Just make sure that Step 1 takes place before Nov. 27 so that there's time for Step 3 to also take place in 2019.

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