

TAX MATTERS

Buying gifts for family members can come with tax consequences



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1 COMMENTS

Who doesn't like a nice gift? Valentine's Day is upon us, and I stepped up my game this year by buying Carolyn some jewellery. Last year, I bought her a fruitcake – which didn't go over so well. I've since learned that Johnny Carson once said that fruitcake is the worst gift ever. He insisted that there's only one fruitcake in the entire world, and people keep sending it to each other.

Today, I want to talk about gifts to family members. No, I'm not talking particularly about birthday, anniversary or Valentine's gifts, but gifts that you might make to your family as part of your estate planning. Here's a list of things you should understand about gifts to family.

YOU COULD FACE TAX WHEN MAKING A GIFT

Unlike the United States, we don't have a "gift tax" in Canada. But there could still be tax consequences. If you happen to gift cash to someone, you won't trigger a tax bill. But when you gift other assets, you're deemed to have sold them at fair market value, which could trigger a taxable capital gain if the assets have appreciated in value. And by the way, if an asset that you gift has declined in value, your loss will be denied if you transfer the asset to your spouse, the asset is depreciable property, or it's personal-use property. Finally, any gift to your spouse is considered to take place at your adjusted cost base, so no capital gain or loss is triggered.

WATCH OUT FOR THE DOUBLE-TAX PROBLEM

If you sell an asset below fair market value, rather than making a gift, a double-tax hit can result. Suppose, for example, you own an antique car that you bought for \$25,000 but is now worth \$40,000. If you sell that car to, say, a child for \$25,000, you'll be deemed to have sold it for \$40,000, and you'll realize a \$15,000 capital gain (half of which is taxable). Your child, on the other hand, will have an adjusted cost base of \$25,000 – the amount she paid. If she then sells it for \$40,000, she'll realize a \$15,000 capital gain, and taxes will be paid all over again on that same gain. In this example, you'd be better to either gift the asset to the child, or sell it to her for fair market value

(\$40,000) and simply take back a promissory note, rather than cash, for the \$15,000 that you don't care to collect from your child. You can then forgive the note in your will with no tax consequences.

BEWARE OF THE ATTRIBUTION RULES

If you gift an asset to your spouse or minor children (or grandchildren), any income earned by your spouse or child on that asset will be attributed back to you and taxed in your hands. The exception is that capital gains or losses realized by a minor child are not attributed back to you. In addition, any second generation income (that is, income on the income) earned by your spouse or child will not be attributed back to you either.

YOU COULD BE LIABLE FOR SOMEONE ELSE'S TAXES

If you make a gift to another person at a time when you owe taxes to the government, the recipient of your gift could be jointly and severally liable for your tax bill. Suppose, for example, a father has his 2018 tax return reassessed in 2020 and owes the taxman \$20,000 as a result. Suppose also that, in 2019, he had paid \$15,000 toward a child's wedding costs. The child could be liable in this case for up to \$15,000 of Dad's tax bill. Crazy, I know.

A TRUST CAN ALLOW YOU TO MAINTAIN CONTROL

Rather than making a gift directly to a family member, you could make a gift to a trust, which can allow you to keep control over the assets you're gifting. There are specific "attribution rules" to consider when setting up trusts, so you'll want to speak to a tax pro about who should be the trustee(s) (trustees control the trust assets) and beneficiaries.

U.S. CONNECTIONS CAN COMPLICATE GIFTS

A U.S. citizen, resident or Green Card holder (U.S. persons) could face tax in the U.S. when making gifts that are over and above the exclusion amount of US\$15,000 (for 2020) a recipient per year. Even non-U.S. persons (including Canadian citizens and residents) could face U.S. gift tax and filing obligations on assets physically located in the U.S. such as real estate and tangible personal property. Speak to a tax pro about it. Finally, if you make a gift to a U.S. person it could trigger filing requirements (U.S. Form 3520) in the U.S., if the gift is large (more than US\$100,000).

The good news? My gift of fruitcake to Carolyn triggered no taxes last year.

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