Transfer to Spouse

Sometimes we dig a hole for ourselves. Maybe a spouse can help us out.

Yellow, shiny metal toys with big black wheels and scoop buckets come with built-in vroom-inducing sound effects. Not the fake motor noises of the electronic era -- the little kid's lips -- the imaginary mighty machine kind of vroom. I never really got over that vroom, and may not any time soon.

So when a major project was required at our home, I scoffed at my wise companion's advice to hire a professional and went forward with vroom. Big vroom. Me like to dig holes with big machine vroom. The kids knew what I was up to.

The holes were mostly dug without mishap. Meticulousness and brute power are beautiful companions. As a friend (a professional big machine guy) said to me: "A good operator can tickle the back of the neck of a kitten with that machine."

So I have to admit feeling somewhat proud when I climbed down in to the large hole I had dug next to our home, perfectly-sized for our new septic tank, squeezed in precisely beside our old tank on one side and our old septic field on the other. I had missed the action end of both by just a few inches, and had decided to hand dig around one of the active lines to avoid kitten-tickling it too much with the big yellow machine.

I didn't break the line, but was so close to the sewage field that it decided to take the pathway of least resistance to greet me in my deep world of meticulous power. About then the cat came and stood over the hole looking down at me. "How's it going there big guy? I got an itch at the back of my neck. Do you mind?"

Always listen to your wife.

And speaking of spouses, and digging holes, and stuff, you might hold a security that you expect to significantly appreciate in value (because say it is in a hole?) and you would like to have its future appreciation taxed in the hands of your spouse rather than in yours. If so, the following tax planning strategy may help you achieve this without getting your boots in the wrong sort of tax trouble.

Why transfer an appreciating security to a spouse?
Consider one of the following two reasons:

a) To achieve income splitting with your lower-income spouse. This means that any future capital gains, if this transfer is conducted properly, will be in the lower earning spouse.

b) Your spouse has unused capital losses, but no capital gains
If your spouse has unused capital losses, you could transfer a security you anticipate will appreciate in value to them to allow their unused capital losses to offset any future capital gains from the transferred security, which could potentially result in tax-free capital gains.

How to implement this strategy

Method 1:
1. You sell your security on the open market.
2. Then you report the capital gains you triggered in Step 1 on your tax return.
3. Your spouse buys the same security on the open market with their own money.

If your spouse purchases the security for the fair market value with their own money, you will not trigger the attribution rules, and any future capital gains (or losses) will be taxable in your spouse's hands.

Method 2: Transfer the security to your spouse in-kind for the fair market value
Instead of you selling your security on the open market and your spouse purchasing the same security, you may consider transferring your security to your spouse in-kind. To avoid triggering the attribution rules, your spouse will need to pay you the fair market value of the security using their own funds.

1. You transfer your security in-kind to your spouse.
2. Your spouse pays you the fair market value consideration using their own funds. The fair market value paid becomes your spouse's adjusted cost base.
3. You report the capital gains you triggered in Steps 1 and 2 on your tax return.

When considering this method, consult your advisor about how they can accommodate your request from an administrative standpoint. There could be additional tax preparation fees since you also have to file an election with your income tax return to transfer the security to your spouse at the fair market value.

Honestly, method 1 (above) is much more straightforward, and just as effective.

Superficial loss rules (if securities are in a loss position)
To avoid triggering the superficial loss rules, your spouse needs to wait 30 days from the settlement date on which you sell your security before they repurchase the same security. In this situation, you cannot transfer your security in-kind to your spouse.

The strategy you choose will depend on your situation and whether your spouse has their own funds to facilitate the transaction. Beware, however, of triggering the income attribution or superficial loss rules, which could defeat the purpose of your strategy.

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