Many older individuals believe that it is better to give away their excess money while they are living, rather than make bequests through a will. Although there are many compelling reasons to take this approach, there are also several points that should be considered prior to making a sizable gift.

Reasons for giving away money range from efforts to minimize future taxes or probate fees, to helping a family member with an immediate need, such as a home or education costs. Still others enjoy the satisfaction of seeing the recipients use the funds to enhance their lives. Whatever the objective, individuals must understand that a gift is irreversible. This type of transaction should not be made if an individual could one day need the money, should their circumstances change.

Some of the questions that should be asked before gifting include:

- Will it bother the giver if the gift is squandered, used or given away in a manner the giver never anticipated?
- Has the giver kept enough money to last him or her throughout their lifetime?
- What taxes will the giver have to pay on the transfer of property?
- Will the income from the gifted property be attributed (taxed) back to him or her?
- Are the recipients of the gift mature enough to handle the money?
- Could the money come into the hands of an unwanted recipient?

Considerations

Control

A few of the questions mentioned above deal with the character of the recipient and can only be answered by the giver, based on their personal knowledge of the intended recipient. In gifting money or property outright, one gives up ownership and control. An individual must be willing to accept the actions of the recipient, even if, in the giver's opinion, the recipient were to spend the money foolishly. Only through the use of a trust could the individual, as the trustee, maintain some control over the assets.

Retirement needs

Many people may wonder how much they can afford to give away. A financial planner can help project the amount needed to meet future financial requirements. It is wise to use different assumptions and examine a number of factors, such as inflation, rate of return, numbers of years in retirement and costs of health and domestic care and to be conservative in each case, since the transaction is irreversible. If an individual runs out of money because of an overly optimistic projection, he or she would have no claim to the gifted money.

Family law considerations

Family law legislation varies from province to province and needs to be considered, particularly with gifts or inheritances to a married recipient or to someone about to be married. For example, in Ontario, if the marriage were to fail, an issue would arise as to whether the gift would be excluded from the calculation of the individual's net family property (NFP), which is the value of all property owned by one spouse on a particular date after certain amounts are deducted or excluded. The rules governing this calculation are complex and heavily dependent on the facts and circumstances. For example, income from gifts or inheritances received during the course of a marriage can be excluded from NFP calculations if an express statement is made by the donor (through a Declaration of Gift) or testator (through a Will). For gifts received before marriage, the original gift could be deducted from NFP, but any growth in the value from the date received until the marriage breakdown would be considered part of NFP and, therefore, subject to division.

Among the considerations that a court will take into account when determining whether the gift would be included or excluded from the NFP is the form the asset has taken – for example, was the asset kept separate or co-mingled with the other spouse's funds, or, can the gift be traced to a car, piece of art or other object purchased with the inheritance? Another consideration might be the intended recipient of the gift – was it for an individual or for a couple? Note that if the funds have been invested in the matrimonial home, they are automatically subject to division (unless excluded by a marriage contract in some provinces). If the intention is that the gift should be kept out of the matrimonial property regime, for evidentiary purposes, it is recommended that gifts be kept separate from joint assets and, if possible, not invested in the matrimonial home. Specific legal advice should be obtained.

Tax implications

The following is an overview of a few of the principles and rules affecting gifts. (Similar rules apply if the gift is made using a trust.) Note that individuals considering making a gift should consult a professional tax advisor to identify tax implications and for the preparation of tax returns.

There are two levels of taxation that individuals need to be aware of:

1) capital gains tax on the disposition of property when it is transferred

2) ongoing taxation of income and gains generated from the property after the transfer

On the date the gift is made, the giver will be deemed to have disposed of the property at its fair market value (FMV) and will be responsible for any taxable capital gains accrued since the property was acquired. The recipient receives the gift at FMV, which is their adjusted cost base. (There is an exception: If the individual gifts the property to a spouse or common-law partner, the individual is deemed to be disposing of the property at its adjusted cost base and his or her spouse or common-law partner receives it at the same adjusted cost base, unless the gifting spouse or common-law partner elects otherwise. As such, there is no capital gain or loss at the time of gifting between spouses or common-law partners.) In the case of a cash gift, there is no capital gain so there are no immediate tax consequences associated with the gift.

The other level of taxation on a gift is the ongoing tax liability arising from income and capital gains generated by the property after the transfer. In all cases, compound or second-generation income (income generated on previous income whether attributed or not) is taxed in the hands of the recipient and not the giver. For example:

- A gift to a related minor (under 18) results in income on the amount of the gift (interest and dividends) being attributed to a related giver until the year in which the child turns age 18. Capital gains and second-generation income subsequent to the transfer are always taxed in the hands of the child.
- Generally, a gift to an adult (other than a spouse) does not result in any liability for taxes being attributed to the giver.
- A gift to a spouse or common-law partner results in all earnings being attributed to the giver, whether it’s interest, dividends or taxable capital gains (including gains not realized at the time of the gift).

Note that the attribution of capital gains to the giver can be avoided by making a loan, instead of a gift, to the intended recipient. Interest must be charged on the loan at a rate at least equal to Canada Revenue Agency's current prescribed rate. This general discussion of the tax considerations of gifting assumes that the individuals involved are residents of Canada.

Only after these factors have been carefully examined should an individual consider giving away a portion of his or her money. There are pros and cons to each scenario and individuals would be wise to ensure the decision to give money away is theirs alone and that they are not in any way coerced or influenced by others.

The above information is for general purposes only and individuals should contact their professional tax advisor prior to making a gift of property or money.

4473 – 05/09