

Planning for Gifts to Adult Children

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Parents are often interested in making substantial gifts to their adult children to give them a good start in life, to mark a significant occasion or simply to enjoy seeing their children benefit from their accumulated wealth. However, you should plan in advance to ensure any gift does not suffer unintended consequences.

Planning for gifts to adult children

There is a three-pronged legal test to determine whether or not a transfer of property (during lifetime) is a gift. Firstly, there must be a clear and unequivocal intention of the donor (the transferor, or the giftor), as evidenced by the donor's behaviour and/or documentation, to make the gift without having received any consideration, nor the expectation of receiving any future consideration, remuneration or benefits associated with the transfer of that property to the donee (the recipient). Secondly, there must be physical delivery or transfer of the property from donor to donee, to complete the gifting transaction. And lastly, there must be knowledge of, and actual acceptance of, the gifted property by the donee. Intention of the donor is most commonly the point of contention, legally speaking, when there is a dispute as to the nature of the transfer either due to a taxation or a creditor challenge. The onus is on the recipient to prove a gift was intended by the donor. If one of the above conditions is not met, the transfer is likely not a gift.

Is it prudent to gift to adult children?

Parents often want to give their adult children at least some of their wealth during their lifetime, because parents derive satisfaction and contentment from watching their children enjoy the fruits of their lifelong labour, rather than have the children wait for an inheritance. However, the decision to gift during lifetime rather than at death requires careful consideration of potential negative consequences in the event of certain circumstances. Some of the important issues to consider are protection of the property on a long term basis, and tax consequences.

What about marriage breakdown?

Each province in Canada has different rules that offer varying degrees of protection for property received by gift or inheritance in the event of a breakdown in a

marriage or spousal relationship. A consideration would be how the child intends to maintain ownership of the gifted funds going forward. If the gift is comingled in his/her community property it may lose its potential protection of gifted property. This protection may be available in the context of a property claim on marriage breakdown, or with respect to a claim against the estate of a deceased spouse. However, the statutory protection may not be sufficient because there are many exceptions and they are strictly interpreted. In addition, children may move from one province to another, making it uncertain as to what the applicable law will be in the future.

Transferring the gifted property to a trust of which the children are both income and capital beneficiaries is sometimes recommended. In addition to offering some protection from spousal claims, it can also prevent the child from voluntarily transferring the property to the spouse. It is important that the trust you create is a discretionary trust and that your child, if he or she is one of the trustees, does not have veto power over the trust property. It is also recommended that you are not a trustee of the trust. Gifting to adult children by way of an inter-vivos trust ensures that the property provides the children benefits from the property while you maintain at least some control of the property. In addition, the trust may protect the property from creditors and others making claims against your children. Professional advice is essential if the trust route is chosen to ensure that it provides the appropriate protection for your circumstances and avoids certain tax traps.

Alternate strategies

Protection of family assets in the event of divorce suffered by their adult children is an important goal of many high net-worth individuals' estate planning. Strategic gifting to adult children can advance this goal. For example, at law, gifts and inheritances received during marriage are (in the

right circumstances) excluded from division of property in the event of divorce or death of the recipient. Additionally, a valid marriage agreement may exclude property acquired during marriage from communal division upon divorce or death. Thus, if you are contemplating transferring significant assets to your adult children, the optimal time frame for such transfers for purposes of asset protection may be after the date they marry.

By delaying the gifting until after the date of your child's marriage, you may have engaged the protection of property provided for in the family law, with respect to the exclusion of property from equalization claims upon divorce or death. Since the matrimonial home is often treated differently at law, in that it is not subject to protection from division even if it is gifted after the date of marriage, it may be necessary to take further protective measure by way of attaching a *Demand Promissory Note* to encumber the couple's matrimonial home. With respect to any other property you may wish to gift to your married child (not associated with the matrimonial home), executing a *Deed of Gift* can provide the protection you seek, as evidence that the property was not acquired during marriage but rather, received as a gift, during marriage.

You may decide to register a mortgage against a home which you have purchased for your child as one way to protect your assets. If the gift you are contemplating is not real estate, but rather cash, you may want to consider simply creating a debt where you are the creditor and your child and his or her spouse, jointly, are the debtors, in an amount equal to the value of the gift. This can be achieved by way of a personal loan agreement with an accompanying non-interest bearing demand promissory note. Properly structured, such an agreement would be an enforceable contract which you may use to demand repayment to protect the assets, in the event of marriage breakdown between your child and his or her spouse.

Alternatively, and depending on the nature of the property, a *Deed of Gift* may be used to protect the property in the event of a marriage breakdown between the child and his or her spouse.

Lastly, as previously discussed, by entering into a valid marriage contract it is possible to achieve asset protection where exclusion of certain property from communal property division upon divorce or death is desired.

Is the gift taxable?

In Canada there is no gift tax. However, where a gift consists of capital property with an unrealized gain, and where the transfer is not between spouses, the transfer is deemed to occur at fair market value. This means that capital gains tax will be payable by the parent in the taxation year the property is gifted to the child. Tax will be payable by the transferor (the parent) on the gain, based on the difference between the property's cost base and its fair market value at time of gifting. The recipient child acquires the property at the fair market value at the property's new cost base. That is, there is an adjustment to the property's cost base such that, when the adult child disposes of the property in the future, the capital gains tax payable by the child will be based on the gain from the date of gifting to the time of child's disposition of the property.

Gift away but give responsibly

Gifts can lift our spirits and reinforce our bonds. It also ensures that significant and meaningful assets are retained, used and enjoyed for many generations. Gifting cements our family history and enhances future family wealth. However, it's important to seek the advice of your legal and tax advisors before embarking on any gifting strategy to make sure that the gift meets the needs of all parties, and stays within the family.

For more information, speak with your BMO financial professional.



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