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PROPERTY TRANSFERS BETWEEN CROSS-BORDER SPOUSES AND PARTNERS

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Jacinthe Marquis helps ultra-high-net-worth families define and implement their vision of their wealth, family and community. She supports them in estate planning, business succession, philanthropy and wealth protection.

With many years of experience in cross-border taxation, Jacinthe also helps families navigate the tax issues related to dual citizenship and the acquisition, management and transfer of wealth on both sides of the border during their lifetime and upon death.

Jacinthe began her career as a tax professional. For a few years now, she has been expanding her horizons to support clients in managing their wealth and achieving their mission—for themselves, their community and future generations.

Jacinthe is a member of STEP. She is known for her authenticity and ability to provide practical and accessible advice in both English and French.

Executive Summary

Property transfers between related individuals are subject to specific tax rules. If you are a cross-border couple, you should note that the rules that apply in Canada and the United States (U.S.) are quite different.

This article touches on Canadian and U.S. tax rules that apply to transfers between spouses and partners. If you or your spouse or life partner is a United States citizen or resident, you'll be faced with additional challenges. We will compare how Canada and the U.S. differ in their tax treatment of transfers, and showcase these differences in a series of case studies.

Only deliberate, lifetime transfers are covered in this article. Transfers as a result of a legal settlement (for example, a divorce) or death or by way of loan, as well as indirect transfers using a trust or another entity, are not covered.

This article is intended to begin the thought process, but not meant to cover every detail, nuance or exception. Please consult your legal and tax advisers to examine these rules in light of your own situation.

Are you a cross-border couple?

If you or your spouse or partner is a United States citizen or resident, you are considered a cross-border couple. United States persons (both citizens and residents) are subject to U.S. taxation on their worldwide income and capital. A cross-border couple is affected by both Canadian and U.S. taxation.

If you or your spouse or partner is a United States citizen or resident, you are considered a cross-border couple.

If both spouses or partners are Canadian but they own U.S. situs assets (for example, U.S. real estate), they may also be affected by both taxation systems. For the purposes of this article, we treat these couples as cross-border couples.

What is a transfer of property?

All transfers in cash or in kind, direct or indirect, typically qualify as transfers of property. You can generally treat any transaction that depletes one spouse or partner and enriches the other as a property transfer, even if it's subject to a condition or the passage of time. The grant of a right to use property is also treated as a transfer.

Direct transfers between spouses and partners

Overview of the Canadian tax system

A property transfer between Canadian-resident spouses or partners[1] triggers two main tax consequences:

1. A disposition of the property for proceeds equal to the transferor's cost basis in the property. In essence, the transfer triggers no gain or loss to the transferor spouse or partner. The recipient spouse or partner acquires the property at the transferor's cost basis.
2. Attribution of the future income and gains to the transferor spouse or partner. This rule is intended to prevent income splitting between spouses or partners. Any income and capital gain from the transferred property (or substituted property) is attributed back to the transferor spouse or partner and subject to tax in the transferor spouse's or partner's hands.

If consideration is received for the transferred property equal to its fair market value and an election is filed, then the attribution rules will not apply. In these circumstances a capital gain may be realized.[2] Other exceptions may apply.

Overview of the U.S. tax system

The U.S. tax system treats a married couple[3] as a family unit. This is evidenced by a number of provisions, including the ability of married couples to file a joint U.S. income tax return. In essence, the U.S. is not concerned with income-splitting between spouses. American-citizen spouses can transfer unlimited amounts of property between them tax-free.

A cross-border couple comprised of a U.S.-citizen and a non-U.S.-citizen spouse is not treated the same way. This follows logically, as most property that transfers from a U.S. spouse to a non-U.S. spouse "exits" the U.S. tax system. A transfer that occurs between two non-U.S. spouses may also be U.S. taxable, if the property in question is a U.S. situs asset. Other rules must therefore be considered for cross-border couples.

In the United States, a property transfer that is not a sale or exchange for adequate consideration is treated as a gift, rather than a deemed disposition of the property. Instead, it gives rise to Gift Tax. Those transactions that qualify as part-sale, part-gift are beyond the scope of this article.

Gift Tax has no Canadian equivalent. It's a transfer tax assessed on property value, irrespective of the accrued gain or loss to the donor. The tax applies to the donor, not the recipient. Where the donor spouse is a U.S. person (citizen or resident), Gift Tax applies to all transfers, subject to the annual and lifetime exclusion amounts. Where the donor spouse is not a U.S. person, Gift Tax applies only to transfers of U.S. situs property. The cost basis of property received by gift carries over from, and is identical to, the transferor's cost basis.

For calendar year 2022, gifts from a U.S. spouse to a non-U.S. spouse up to US$164,000 are exempt from the U.S. Gift Tax. The U.S. donor spouse can elect to utilize their lifetime exclusion amount (US$12.06 million in 2022) to shelter part or all of the excess gift amount, if any. Gifts of U.S. situs property between non-U.S. spouses are eligible for an annual exclusion of US$16,000 only (2022). No lifetime exclusion amount is available. Gifts in excess of the annual and lifetime exclusion amounts are taxed at the rate of 40% of the property value.

[1] In this article, spouse refers to someone to whom you are legally married. Partner refers to a common-law partner under the Income Tax Act, which means someone who cohabits with you in a conjugal relationship, provided the two of you have cohabited for the past 12 months or are jointly parents of a child.

[2] Note that any realized capital loss would be denied for tax purposes and instead added to the cost base of the recipient spouse or partner.

[3] See section entitled "Not all couples are equal" for detail.

Not all couples are equal

In Canada, spouses (that is, married individuals) and common-law partners are treated the same for tax purposes. In the United States, only marriage and civil unions are recognized; common-law partners are treated as single individuals. This additional distinction can create a mismatch in the Canadian and U.S. tax provisions that apply to a given transfer of property between life partners. If you are in a common-law partnership, you should be mindful of this cross-border distinction when you research this topic or consult with tax professionals.

It's quite common for couples to record title to their principal residence in a proportion that differs from their individual contributions. Where the couple is a cross-border couple, additional issues can arise.

Case studies

Here are a few cases that illustrate the concepts we've been discussing. The comments presented with each case don't purport to cover all relevant issues but illustrate some of the cross-border tax issues that we've highlighted.

Case 1–Principal residence: gift from U.S. spouse

Amanda and Peter are a married couple. Amanda is a dual citizen while Peter is a Canadian citizen and not a U.S. person. They reside together in Canada. Amanda and Peter purchase a new home in 2022 for a purchase price of C$800,000, which they intend to use as their principal residence. Both are high-income earners. Amanda is a physician and she is concerned with protecting her assets from potential creditors. Peter's profession doesn't carry the same concerns. They decide that title to their new home will be registered in Peter's name although they each contribute 50/50 towards the purchase price.

Cross-border tax comments

We consider Amanda and Peter as a cross-border couple because Amanda is subject to both Canadian and U.S. taxation. The 50/50 payment for their new home that is then registered in Peter's name only, constitutes a transfer of property from Amanda to Peter.

From a Canadian tax perspective, this transaction doesn't carry significant implications. The transfer from Amanda to Peter takes place at cost and no gain is realized. Since the property is intended as their principal residence, it won't produce income, therefore attribution is not a concern. Half the gain on the future sale will attribute back to Amanda, but if they can use the principal residence exemption, this will have no tax effect.

From a U.S. tax perspective, Amanda has made a taxable gift of C$400,000 to Peter. This amount is in excess of the annual exemption for transfers to a non-U.S. spouse (the exemption is US$164,000). The excess (in U.S. dollars) is subject to U.S. Gift Tax. Amanda must file a U.S. Gift Tax return for the year 2022. She may choose to claim a portion of her lifetime exemption (US$12.06 million) in lieu of paying the tax.

It's quite common for couples to record title to their principal residence in a proportion that differs from their individual contributions. Where the couple is a cross-border couple, additional issues can arise. It's important to consult your advisors early on.

Case 2–Principal residence: Common-law partners

Let's assume the same facts as in case 1, except that Amanda and Peter are common-law partners.

> Gift Tax does not apply to a transfer from the non-U.S. spouse where the subject property is not a U.S. situs asset.

Cross-border tax comments

From a Canadian tax perspective, the tax consequences are the same as highlighted in case 1, as spouses and common-law partners are treated equally under Canadian tax law.

From a U.S. tax perspective, the tax consequences are the same, but the amounts differ. Since Amanda and Peter are treated as two single individuals, the annual Gift Tax exemption is limited to US$16,000. The encroachment on Amanda's lifetime exemption amount or her Gift Tax bill, whichever the couple chooses, would be proportionately larger as a result.

Case 3–Principal residence: gift from non-U.S. spouse

Now let's re-examine Case 1, this time assuming that Peter is the dual-citizen spouse and Amanda is the Canadian spouse.

Cross-border tax comments

From a Canadian tax perspective, the tax consequences are the same as in Case 1, because Canadian tax law is indifferent to the couple's U.S. status.

From a U.S. tax perspective, there is no Gift Tax in this instance because the donor spouse (Amanda) is a non-U.S. person, and the subject property is not a U.S. situs asset. A U.S. spouse can receive unlimited amounts from a non-U.S. spouse without triggering U.S. tax consequences at the time of transfer. But the U.S. recipient spouse (Peter) should be aware of reporting obligations. Gifts in excess of a certain threshold (historically, US$100,000) received from a non-U.S. person must be reported to the IRS on a statutory form. The U.S. spouse should consult a tax advisor.

Transferring property from the non-U.S. spouse to the U.S. spouse may increase the couple's exposure to U.S. income tax and U.S. estate tax on death. Once again, it's important to consult a tax professional.

Case 4–Attribution of rental income

Let's again assume the same facts as in Case 1, except Amanda and Peter purchase an income-producing property instead of a home.

Cross-border tax comments

From a Canadian tax perspective, the transfer from Amanda to Peter takes place at cost and no gain is realized. The rental income is subject to the attribution rules: half the income attributes back to Amanda as long as Peter owns the house and they are married. When the house is subsequently sold, half of the taxable capital gain will attribute to Amanda as well.

From a U.S. tax perspective, the purchase triggers Gift Tax. The same consequences as outlined in case 1 apply. The property belongs to Peter. The rental activity and the ultimate sale of the house don't carry U.S. tax implications because they take place in the hands of a non-U.S. person.

Note that this situation creates a divergence between Amanda's Canadian taxable income and her U.S. taxable income. She should consult with her tax advisor regarding any tax implications.

Conclusion

As a cross-border couple, you'll be faced with additional challenges when transferring property between you and your spouse or partner. You should seek advice from a cross-border tax and legal professional in anticipation of a spousal or partner transfer so you are aware of potential tax consequences.

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