

Income Splitting With Children

The tax implications of income splitting with children depend on whether the child is a minor or adult child. For these purposes, an adult child is any child that is over the age of 18.

Adult Children

Gifted Funds

Funds that are gifted to an adult child do not result in income attribution back to the parent.

The only tax consequences that would occur for the parent would be a deemed disposition if they were gifting any asset other than cash. Note that there is no limit as to how much the gift can be, and there can not be any strings attached. Once the funds are gifted, they are the adult child's to do with what they want.

Education Funding—gifting funds to adult children can be an effective way to fund education expenses. Using an example where it costs a parent \$5,000 to send their child to school, it takes \$100,000 of capital to fund the income stream required to pay for school (assuming a 10% rate of return and a 50% marginal tax bracket). If funds were gifted, only \$50,000 would be required assuming the same 10% rate of return. The difference lies in the tax treatment of the income. With personal, education and tuition credits, the adult child is at a lower (or nil) tax rate and would therefore pay no tax.

Loaned Funds

The above rules change when funds are loaned to an adult child at a low, or no rate of interest. Any interest or dividend income received will be taxed in the hands of the parent, however capital gains will be taxed in the hands of the child.

Note that one way around the attribution rules in this case is to use a loan to an adult child at Revenue Canada prescribed rates (the current rate is 4%). The interest paid on the loan is taxable to the parent, however all of the investment income would be taxed in the hands of the child. This strategy would effectively tax any investment returns over 4% in the hands of the child.

Minor Children

The tax implication of funds gifted or loaned to minor children are the same. In both cases, interest and dividends are taxed back to the parents, however capital gains would be taxed in the hands of the minor.