

How to Make Gifts to Children



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Most children's financial needs do not end on graduation. On the contrary, as they become older, their financial needs grow. Many parents attempt to assist their children in acquiring their first car, home or business. When children run into financial difficulties (as they often do), their parents are usually the first source of relief approached. For other parents, children represent an opportunity for effective tax and estate planning. Unfortunately, poorly planned gifting can often result in disappointment and unpleasant surprises for both the donor and recipient of the gift. As a family law lawyer, I regularly see parents becoming involved in their children's matrimonial disputes. The financial assistance that just a few years before was given and received in a spirit of generosity and goodwill, has now become a source of legal wrangling. Was it a "gift", or a "loan"? Was it given to the child or to the child and his or her spouse? Who gets the benefit when the couple's family property is equalized? In this article I will offer some practical advice to would-be donors and recipients.

Gifts and the Family Law Act

Many people are under the mistaken impression that all gifts are excluded from the division of property that follows a marriage breakdown. Under Ontario's Family Law Act (FLA), there is a general rule that gifts or inheritances received from a third party during the course of a marriage are excluded from the equalization of net family property provided for in that Act. However, gifts or inheritances received before the date of marriage are not excluded, although the recipient is entitled to a deduction for the value of such property as of the date of the marriage. Accordingly, any increase in the value of the property after the date of the marriage would be subject to equalization. For parents, this rule has important implications: if the property which is to be the subject of the gift is likely to increase in value, then they should, where possible, defer from making the gift until after the wedding. Secondly, the exclusion is only available to the party to whom the gift was made. If the gift was made to one spouse only, that spouse will both own the property and be entitled to exclude

it from an equalization. However, if the gift can reasonably be construed as a gift to both spouses (as would usually be the case with respect to wedding and anniversary gifts), then each spouse would be a joint owner of the property and each would be entitled to exclude his or her half from any equalization. If the latter is not the desired result, then the person making the gift should clearly indicate the intended beneficiary when the gift is made.

Income-generating Gifts

Income from property received from a third party during the course of the marriage is excluded from equalization only if the person making the gift or bequest has expressly stated that such income is to be excluded from the recipient's net family property. While this statement need not be in writing, for obvious reasons it should be. Since the passage of the FLA in 1986, most wills drafted in Ontario have included this clause. Pre-1986 and non-Ontario wills should be carefully reviewed to ensure that this clause is present. Inter-vivos gifts should be accompanied by a written statement of such intent.

The Matrimonial Home Exception

The rule allowing an exclusion for property gifted or inherited from third parties during the marriage does not apply to a matrimonial home. "Matrimonial home" is defined in the FLA as property which is ordinarily occupied as a family residence at the time of

separation. There may be more than one matrimonial home. City residences and vacation properties may qualify. The matrimonial home exception can represent a major problem for a potential donor. Once gift proceeds are used to acquire, improve, or maintain a matrimonial home, the exclusion for those funds is lost. Similarly, a gift of property that becomes a matrimonial home (say a cottage property or a piece of land on which the child and his spouse have built a cottage) is "in the pot" for equalization notwithstanding that the entire property may have been gifted by one parent.

Protecting the Interest of the Donor

How can a potential donor assist his or her child but ensure that the benefit of his or her generosity remains within the family if the child's marriage should fail? There are a number of options:

1. Place Restrictions on the Use of the Gifted Property

The donor may insist, as a term of the gift, as to how the property is or is not to be used. For example, the donor may insist that a gift of cash be invested in securities in the husband's name or that the funds never be applied towards property that is or could possibly become a matrimonial home. For most parents, this would not be considered to be a realistic option. Even if it were, there is no assurance that the recipient of the gift would abide by the donor's wishes.

2. Make a Loan Rather Than a Gift

The equalization provided for in the FLA applies to both assets and debts. By making a loan rather than a gift, the donor becomes a creditor who is entitled to repayment before the family property is divided. The recipient's spouse need not even be made aware of the existence of the loan, much less its terms. A promissory note should be executed and retained for proof of the transaction. The note may provide for no interest or for the payment of interest at a commercial rate (which the creditor may forgive, if so inclined). There may be a defined term or the loan may be payable on demand.

3. Take Security for the Loan

In order to enhance his or her enforcement options and maintain priority over other existing or possible future creditors, the donor may be well advised to take security for the loan. If a significant sum of money is advanced to acquire or improve real estate or a business, a mortgage or other form of security should be considered. So long as the marriage is stable, the security can virtually be ignored. However, in the event of marital difficulties, the security provides the secured party not only with significant protection for his or her investment, but also a powerful lever to influence many

issues that may arise between the spouses (for example, issues relating to the possession, sale or division of proceeds of a matrimonial home).

4. Retain Ownership of the Property in the Donor or in a Trust

In certain circumstances, it may be preferable for title of the property to be retained in the name of the donor or in the name of a trust or to utilize a corporate vehicle to affect either an estate or family law freeze. These options require the consideration of many income tax and estate planning issues which space limitations prevent us from addressing. While no Canadian

court has yet to squarely address the issue, it is unlikely that a mere contingent beneficial interest in a totally discretionary trust would be considered as property having significant value for equalization purposes. These options can, in appropriate cases, provide significant protection against the loss of either equity or control in a marriage breakdown situation.

5. Use a Marriage Contract

The best protection against adverse consequences resulting from a marriage breakdown remains a properly drafted and executed marriage contract. Virtually all of the potential problems considered in this paper could be avoided by

means of such a document. Of course, obtaining such a contract is not a simple matter. Parties contemplating entering into a marriage contract must be prepared to make full financial disclosure, obtain independent legal advice and endure a process that will test the strength of the relationship.

Concluding Thoughts

In a perfect world, parents could assist their children financially without concern for the future viability of their children's marriages. However, in a world of equalization claims and 50% divorce rates, parents have good reason to be cautious. They should carefully investigate all of the options before proceeding.