



**Why should I consider this strategy when rates are low?**

The CRA’s prescribed rate used at the time your loan is established remains in effect for the lifetime of the loan.\* When rates are low, you have an unprecedented opportunity to set up the strategy and maximize your benefit over the long term.

**How can I benefit from this lower rate if I have an existing loan?**

The CRA’s prescribed rate at the time your loan is established always stays in effect – whether rates go up or down. Therefore, it may be worthwhile repaying the original loan and making a new one at the lower rate. Before doing so, you should consult with your accountant or tax advisor to ensure it makes sense given your tax situation.

**Are the interest payments tax deductible?**

Yes, the lower-income spouse can claim the interest payments as a tax deduction. However, the higher-income spouse must report these as income. While this is a drawback, the overall tax savings from the strategy should more than compensate for this as long as the lower-income spouse earns income at a rate that is above the CRA’s prescribed rate used for the loan.

**Why can’t I just loan non-registered assets to my lower-income spouse without receiving the interest?**

If you receive no interest (or other consideration) for the loaned assets, the CRA will simply attribute any investment income earned by the assets back to you and it will be taxed at your higher tax rate.

\*Contingent upon interest payments made annually within 30 days of year-end.

We can show you how much you can benefit from the Spousal Loan Strategy using our Spousal Loan Calculator.

Please contact us for more information.



**Reducing your family’s tax burden**

The Spousal Loan Strategy



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## The Spousal Loan Strategy

### A proven strategy to reduce your family's taxes

- Reduces the tax you pay on assets exposed to your high tax rate – ideal if you have a spouse\* earning little or no income.
- Lowers your combined taxes by transferring income to your lower-income spouse, so it is taxable at their lower marginal rate, through a special loan arrangement.
- Keeping the loan in place compounds the effect over time, as the lower-income spouse can earn income on the income.
- Historically low interest rate greatly enhances the effectiveness of this strategy.

If you have non-registered assets exposed to your high tax rate, you understand the importance of effective tax planning. However, it can be challenging to find truly significant tax-reducing strategies that are effective within the Canadian tax environment.

One proven, yet often overlooked strategy is the Spousal Loan Strategy.

This income-splitting strategy is ideal for families with one spouse who earns a much higher income than the other – and is taxed at a much higher rate. When properly implemented, this strategy can save your family thousands of dollars in taxes every year.

With the Spousal Loan Strategy, you transfer funds to your lower-income spouse through a special loan arrangement at the Canada Revenue Agency's (CRA's) prescribed interest rate. Your spouse is then able to earn investment income on these funds and pay taxes at their lower marginal tax rate.

Your spouse pays you annual interest on the loan but, when properly implemented, the tax savings more than compensate for this. What's more, when interest rates are reduced to historic lows, you have an unprecedented opportunity to maximize the benefits of this unique tax planning strategy.

\*The Spousal Loan Strategy also applies to common-law partners as they are treated the same as married spouses for Canadian tax purposes.

## The Spousal Loan Strategy: How it helps you save taxes

Normally, you achieve no tax advantage when you simply give funds to your lower-income spouse to invest. The CRA attributes any investment income earned on these funds back to you, as if you had earned it yourself, and it is taxable in your hands at your higher marginal tax rate.

This is where the Spousal Loan Strategy can help. By making a bona fide loan to your spouse, and receiving annual interest payments in return, you can avoid triggering the CRA's income attribution rules.

Please contact your Investment Advisor and accountant or tax advisor for assistance with your Spousal Loan Strategy.

### Step 1 – Identify potential non-registered assets.

Determine which assets currently exposed to your high marginal tax rate can benefit from this strategy. These may be funds you have accumulated over time in a taxable non-registered account – or a sudden windfall, such as an inheritance or proceeds from selling a business. Convert the non-registered assets chosen for the strategy into cash, if these are not in cash already. This may trigger capital gains or losses.

### Step 2 – Loan cash to your spouse.

To put the strategy in place, you make a demand loan to your lower-income spouse. The loan is backed by a demand promissory note and a loan agreement that sets out the terms of the loan.

### Step 3 – Your spouse builds a portfolio.

Your spouse invests the entire loan amount in a portfolio in their own name. To benefit from the strategy, design the portfolio to produce an annual income exceeding the CRA's prescribed interest rate on the loan.

### Step 4 – Make annual interest payments.

Your spouse pays you annual interest from the portfolio no later than 30 days after year-end to keep the strategy in effect. The interest must be paid at the CRA's prescribed rate at the time the loan was made. Should the CRA's prescribed rate increase in the future, the loan rate remains at the lower prescribed rate in effect when the loan was originally made.

### Step 5 – Calculate your annual tax savings.

Ensure that the strategy remains effective by reviewing your tax savings with your accountant or tax advisor every year.

### Step 6 – Renew your promissory note.

Ensure that the demand feature of the loan is kept in effect by renewing your promissory note as required.

### Magnifying tax savings over time

The following illustration shows how you could save \$80,447 in taxes over 10 years and \$282,206 over 20 years with a \$500,000 Spousal Loan Strategy.

For this illustration, we assume the lower-income spouse has a 20% marginal tax rate and the higher-income spouse 45%. We also assume an annualized 7% annual rate of return comprised of 1% eligible Canadian dividends, 2% interest and 4% realized capital gains.

	WITHOUT STRATEGY	WITH STRATEGY	
	High-income spouse	High-income spouse	Low-income spouse
Initial asset value	\$500,000	\$ 0	\$500,000
Income generated	\$ 35,000	\$ 0	\$ 35,000
Interest received (paid)	n/a	\$ 5,000	(\$ 5,000)
Before tax income	\$ 35,000	\$ 5,000	\$ 30,000
Tax	(\$ 10,125)	(\$ 2,250)	(\$ 3,050)
Income after tax	\$ 24,875	\$ 2,750	\$ 26,950
Combined income	\$ 24,875	\$ 29,700	
<b>TAX SAVINGS</b>			
1-year tax savings		\$ 4,825	
10-year tax savings		\$ 80,447	
20-year tax savings		\$282,206	

#### NOTES:

- Assumes 1% interest payment on spousal loan (CRA's prescribed rate from the period April 1, 2009 to June 30, 2009). Future rates may vary. Check with your advisor for the current rate.