



# FAMILY WEALTH MANAGEMENT

TEN STRATEGIES TO BUILD AND PROTECT YOUR FAMILY'S WEALTH





## RBC DOMINION SECURITIES INC. FINANCIAL PLANNING PUBLICATIONS

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- › Protecting your wealth by managing risk and using insurance or other solutions
- › Converting your wealth to an income stream
- › Transferring wealth to your heirs and creating a legacy

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## FAMILY WEALTH MANAGEMENT

Most Canadians don't consider themselves "wealthy" – even when they have a relatively high net worth and own million-dollar investment portfolios. Surveys of Canadian millionaires reveal a modest attitude towards wealth, with most respondents viewing themselves as financially secure, rather than wealthy.

Regardless of how you view your financial status, there are some unique financial planning issues and strategies that you should consider when you have \$1 million or more in investment assets.

In this guidebook, we highlight 10 strategies that can help you protect your assets, reduce taxes, plan for retirement and maximize your estate. Together with your tax, legal and investment advisors, you can determine which strategy or strategies, explained on the following pages, make sense for you and your family.

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Unless otherwise indicated, this guidebook assumes you are a Canadian resident that is not a U.S. citizen or a U.S. green card holder.



If you have \$1 million or more in investment assets, your financial situation is more complex than the average Canadian. You pay higher taxes and have a higher standard of living. Maybe you are an executive with a complicated compensation package or a business owner with an interest in a private corporation. In addition, you possibly own or plan to own more than one real estate property and likely have larger estate transfer and charitable giving desires. Furthermore, you are very busy with your day-to-day work and family life and may have not spent the time to determine if you are on track to achieve your retirement goals, as well as other important financial goals, such as minimizing taxes or planning for the eventual transfer of your estate.

### **CREATING YOUR FINANCIAL PLAN**

One of the best ways to start mapping out your financial planning strategy is to step back and have an expert look at your overall financial situation and prepare a comprehensive written financial plan for you and your family. This type of financial plan addresses all aspects of your financial affairs, including cash and debt management, tax and investment planning, risk management and retirement and estate planning. It ensures that you leave no stone unturned related to your financial situation and potential strategies to enhance your wealth.



**FAMILY WEALTH MANAGEMENT TIP**

A comprehensive financial plan is essential if you are a business owner, as you have more complex financial issues due to owning an active business. This includes business succession issues, withdrawing money out of the corporation tax effectively, taxation of the corporation at death, and more. Like many business owners, you may not have a retirement savings strategy, since you are relying on the equity in your business to fund your retirement. A financial plan can help integrate your business and personal needs into a plan to ensure you are able to meet your goals.

- › Projection of your financial situation if the recommended strategies are implemented
- › An action plan that summarizes the key recommendations and a clear guideline for you and your advisor to help monitor their implementation

Speak to your advisor if you require more information about having a comprehensive financial plan prepared for you by one of our financial planning experts at RBC. Depending on your situation, you may only require a simple retirement plan or projection to determine if you are on track for meeting your retirement goals.

A comprehensive financial plan can address the following questions:

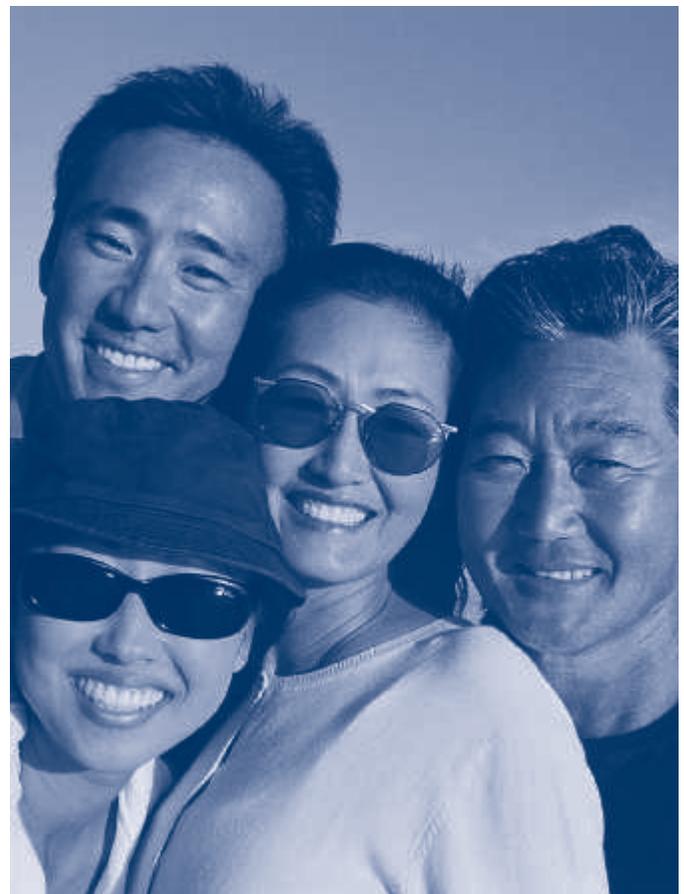
- › Can I retire when I want to and maintain my desired retirement lifestyle?
- › How can I ensure that I don't outlive my money?
- › How can I minimize the taxes I pay each year?
- › Is my investment mix appropriate?
- › If I were to die unexpectedly, would my family be taken care of?
- › How can I protect the value of my estate?

**A HIGHER LEVEL OF CUSTOMIZATION**

In many cases, the key to a professionally prepared comprehensive financial plan is the level of customization it offers.

A customized, comprehensive financial plan should involve the following:

- › In-depth discovery discussion to ensure that your goals, aspirations and objectives are clearly identified
- › Projection of your financial situation (investment, retirement and estate) based on your current strategies and savings rate
- › Recommendation of key investment, tax, estate and retirement planning strategies that are aligned with your goals





### FAMILY WEALTH MANAGEMENT TIP

Sometimes, investors decide against consolidating their assets with one advisor, thinking that they can “diversify by advisor.” This is particularly true of investors with portfolios of \$1 million or more. The idea is that if one advisor doesn’t do well, the other might.

Unfortunately, this is a myth. By dividing your investments among multiple advisors, you actually make it more difficult to properly manage your investments. Since each of the advisors doesn’t know what the others are doing, it often results in over-diversification, conflicting advice and needless duplication of your investments. Furthermore, it’s difficult to know how your investments are performing overall by having your assets spread among more than one advisor.

A better option is to consider consolidating your assets with one knowledgeable advisor who can provide you with a properly coordinated financial strategy.

Diversification is one of the golden rules of investing to reduce risk and boost your return potential over time. Investor surveys indicate that wealthy investors open multiple accounts of the same type, with different financial institutions and different advisors, either because it simply happened this way over time or because they believe it to be an effective way to diversify. But diversification is really about how you invest your money – not where you keep it. Investing through multiple accounts and multiple advisors instead of consolidating your assets with one trusted advisor may impede proper diversification and potentially expose you to greater risk.

The benefits of consolidating your assets with one advisor include:

### REDUCED COSTS

Consolidation is a well-known way to reduce costs. By consolidating your investable assets with one trusted advisor, you will typically pay lower fees, assuming the fees are based on a sliding scale as they are with many investment accounts and programs. By spreading your investments among multiple advisors and multiple financial institutions, you lose these economies of scale.

### SIMPLIFIED ADMINISTRATION AND CONSOLIDATED REPORTING

With consolidation, you bring together all your investment accounts with one advisor, which makes it much easier to keep track of your investments and their overall performance. The paper statements you receive in the mail are minimized and the tax reporting related to your investment income and dispositions becomes easier to manage and more accurate. Your tax preparation fees may also be reduced since your accountant will be spending less time sorting through all the statements and determining the average cost base of identical investments.

### EASIER ESTATE SETTLEMENT PROCESS

Having investment and bank accounts spread among many different financial institutions will make your estate settlement process administratively more difficult for your executor/liquidator and potentially more costly. By consolidating assets, you have peace of mind knowing that after you pass away, your surviving spouse or other beneficiaries will have one point of contact that you trust who will manage their overall assets to ensure they have adequate income.

### **ACCESS TO COMPREHENSIVE WEALTH MANAGEMENT SERVICES**

Consolidation may help you reach a certain level of assets with an advisor so that you may then be eligible for certain specialized services, such as advanced tax and estate planning, comprehensive financial planning, managed investment programs and private banking.

### **MORE EFFICIENT RETIREMENT INCOME PLANNING**

Consolidation also enables you to manage your investments more effectively, helping you structure your investments to generate the retirement income you need. In retirement, you will have many different income

sources, such as government pensions, employer pensions, Locked-in Retirement Savings Plans, Registered Retirement Income Funds, non-registered income and part-time employment income. If you have one trusted advisor managing your investments, it's easier for that advisor to determine how and in what order you should be withdrawing from all the different income sources to maximize your after-tax retirement income.

For convenience alone, consolidation is a strategy worth considering. With consolidation, you work with one advisor who sees the big picture – who understands your overall financial situation and provides the customized advice you need.



## STRATEGY 3 › TEACHING YOUR CHILDREN FINANCIAL RESPONSIBILITY



When someone hears the word “affluenza” for the first time, the first thought that typically runs through their mind is some type of infectious disease. However, that is influenza. Affluenza is the term used to describe the concern shared by many parents that raising children in a privileged environment could give them a distorted sense of value and make them less motivated to work hard to build their own financial resources.

Most people who have built a relatively high level of wealth have done so through hard work, either as a business owner, executive or professional. According to Canadian

expert Jane Whittington of CoED Communications, many of these people are concerned that their children won’t grow up to recognize the value of money or hard work, and they have therefore taken steps to restrict trust funds and inheritances. Whittington suggests the best way to protect your children from affluenza is to prevent it in the first place or to “cure” it as early as possible.

Here are some strategies you can adapt for your children, whether they’re still youngsters, in their teens or young adults:



### FAMILY WEALTH MANAGEMENT TIP

Establishing a family charitable foundation is a great way to instill philanthropic values and money management skills at the same time. The children can take an active part in determining the best methods to use the funds in the foundation to support charitable causes and can also work with an advisor to determine strategies to invest the foundation's capital to meet the annual disbursement quota. See "Strategy 7" for more information on charitable foundations.

### PROVIDE A REASONABLE ALLOWANCE

An allowance can provide much more than a pool of spending money. Whittington advocates using the allowance to instill the three "Ss" of money management: Save, Share and Spend. For example, your 12-year-old might get \$12 per week (\$1 per week for each year of age can be a starting point), divided as follows:

- › **Spend (or accumulate) \$4 allowance each week.** Figuring out how to stretch this amount over the week will develop valuable budgeting skills.
- › **Share \$4 with charitable causes.** Children will develop a social conscience as they decide which organizations and causes to support.
- › **Save \$4 each week for a full year.** Introducing the concept of "paying yourself first" at a young age will help kids manage expectations and recognize the value of saving for the future. Along this line, consider having your children read well-known and easy-to-read financial planning books.

This system is flexible enough to work for kids of all ages and can be easily modified to suit your family's specific objectives.

### SET LIMITS

Parents with above-average financial resources aren't able to say "No" with that old parental standby: "We can't afford it." But they still need to teach the lesson that we don't always get what we want. One solution is to sit down as a family and draw up a monthly or semi-annual budget that accommodates reasonable activities and purchases for everyone in the family. When the kids invariably ask for something that's not part of the plan, you'll have an ironclad answer: "No, that's not in the budget. But maybe we can include it next time."

### TEACH THEM ABOUT FINANCIAL STATEMENTS

When children start earning income, they should understand how to read and prepare their own financial statements. In general, they can prepare their own net-worth statement and cash-flow statements, which should help them with budgeting skills. You also can consider having them take part in preparing or reviewing the preparation of their own income tax return.

### EDUCATE THEM ABOUT MONEY MANAGEMENT

Instead of giving your children a large sum outright during your lifetime or after death, consider having your children sit down with an advisor to discuss strategies to invest their gift or bequest based on their own financial goals. Then, give your children the opportunity to spend all or a percentage of the annual income or reinvest it. Your children can access the capital at certain ages or after certain milestones are achieved.

If you would like assistance educating your children on money management skills, speak to your advisor.

## STRATEGY 4 › EFFECTIVE USE OF SURPLUS ASSETS

By preparing a financial plan (“Strategy 1”), you can determine if you have adequate income and assets to meet your retirement income needs for your and your spouse’s estimated life expectancy. If you determine that you have surplus assets you are unlikely to need during your lifetime, even under very conservative assumptions, consider ways you can protect these assets from high taxes and creditors.

Three options include:

1. Making lifetime gifts or loans to low-income family members
2. Purchasing a tax-exempt life insurance policy
3. Charitable giving

### LIFETIME GIFTS

Do you have surplus assets that you will definitely not need during retirement? Are you also planning on providing funds to your children or grandchildren in the future anyway to help with things such as paying for education, purchasing their first home, starting a business or paying for their wedding? If so, then it probably does not make sense to continue exposing the income from these surplus assets to your high marginal tax rate.

Instead, consider giving some of these surplus funds to family members now, either directly or through a trust if you do not want the children to have control of these assets. There will be no attribution on any investment income earned on the gifted funds if the child is 18 or older and no attribution on capital gains if the child is under 18. If you are concerned about direct gifts to your children, then lending funds and providing your children with only the income earned on the lent funds is another effective strategy as you can call the loan principal back any time.

### TAX-EXEMPT LIFE INSURANCE

Do you have surplus assets that you know will be passed on to your heirs when your estate is settled? If so, it probably does not make sense to continue exposing the income from these assets to your high marginal tax rate.

If there’s an insurance need, consider speaking to your insurance advisor about putting these highly taxed (typically interest-bearing) assets into a tax-exempt life insurance policy where the investment income can grow on a tax-free basis. This way, the amount of tax that would normally be paid to the Canada Revenue Agency (CRA) on the income earned on these surplus assets could instead be paid to your beneficiaries in the form of a tax-free death benefit. If need be, you could access the investment account within the life insurance policy either directly or through tax-free policy loans, which could be repaid after death with part of the death benefit.

### CHARITABLE GIVING

If you want to give some of your surplus assets to charitable organizations, you have many options that can help you create a charitable legacy, while providing some



#### FAMILY WEALTH MANAGEMENT TIP

If you have assets accumulating in a corporation, bear in mind there is a higher tax rate on investment income earned in a corporation than if it was earned personally. Furthermore, there is a potential for double taxation related to the assets inside a corporation at death. As a result, corporate-owned tax-exempt insurance is an attractive solution for surplus funds accumulating in a corporation if there is also a need for insurance. This way, the surplus assets in the corporation can grow tax-free during your lifetime and can also be paid to your beneficiaries as a tax-free death benefit.



tax relief. These include giving directly to qualified charitable organizations, creating a private foundation or donating through a public foundation.

Recent tax changes also make it more attractive to donate publicly listed securities such as shares that have appreciated in value. Now, when you donate publicly listed securities directly to a qualified charity, you are completely exempt from capital gains tax. See “Strategy 7” for more information about tax-effective charitable giving strategies with surplus assets.

Note that due to the potential of escalating health-care and long-term care costs, it is essential that you are prepared for these contingencies before redirecting your surplus assets. Critical illness insurance, long-term care insurance and easy access to credit are a few options to consider with your advisor.



You have worked hard to accumulate your assets, so it's important that you take precautions to protect it from the various risks that are a part of life. When it comes to protecting your wealth, there are three primary risks that you should plan for:

Risk	Common wealth protection strategy
Lawsuit	Asset protection
Market downturn	Diversification
Income loss	Insurance

### RISK OF LAWSUIT

Depending on your employment, business or personal activities, there is always a potential that you may be sued. We live in a litigious society, so it's better to be safe than sorry. Protecting your assets from lawsuits is not about defrauding legitimate creditors – it's about segregating your assets using common and legal strategies at a time when you have no existing or foreseeable claims. In addition to any professional, business, car or house liability insurance you can purchase, the following are some typical strategies to protect your assets:

- › **Gifts.** Although giving assets to a family member reduces the amount of assets you have that are subject to creditors, it also increases the assets subject to the family member's creditors. Furthermore, other than gifts to a spouse, the gift is considered a sale at market value for Canadian tax purposes, potentially triggering a taxable capital gain.
- › **Trusts.** Transferring assets to a trustee of a formal trust results in a loss of legal ownership and some control of the funds, thus reducing your assets subject to creditors. However, you need to be confident that the trustee is someone who will protect and manage your assets in your best interests. Consider a corporate trustee for this purpose due to their reputation and expertise in managing trust assets. Offshore trusts may provide greater creditor protection than domestic trusts due to a specific country's creditor protection laws and the potential unwillingness of a domestic creditor to chase after assets in a foreign jurisdiction.
- › **Life insurance.** Based on provincial laws and court precedents, if an insurance policy is structured properly, the investment component of an insurance policy is not subject to creditors.



- › **Business owners.** If you are a business owner and you have accumulated surplus assets in your business that are not needed for operating expenses, then consider transferring these assets to a holding company. This can help protect the assets from the operating company's creditors. In addition, consider the pros and cons of having your company contribute to an Individual Pension Plan (IPP) in order to boost your retirement assets. As a bonus, the assets in an IPP are creditor protected.

### RISK OF MARKET DOWNTURNS

As indicated in “Strategy 2” diversification is one of the golden rules of investing to reduce your risk of losing capital due to market downturns. Traditionally, diversification has meant allocating your assets between the three main asset classes (cash, fixed income and equities) as well as between different geographic areas and sectors of the economy. More and more people with \$1 million-plus investment portfolios are considering alternative investments for further diversification to protect assets and boost returns. Speak to your advisor about different alternative investment options such as hedge funds, segregated funds and principal-protected structured notes.

### RISK OF INCOME LOSS

If you become disabled or die, are you confident that your family will have adequate financial resources to maintain their lifestyle? Adequate disability and life insurance coverage should be a top priority when it comes to planning your finances. Without the proper coverage, you risk rapidly depleting assets you have worked so hard to accumulate and having a much lower standard of living. You should also have a discussion with your insurance advisor on the costs and benefits of critical illness and long-term care insurance, which are becoming increasingly necessary as more people survive illnesses and diseases than ever before, and require additional care and financial support as a result.

## STRATEGY 6 › VACATION HOME PLANNING

Many families own a vacation property or would like to purchase a second property as a family cottage in Canada or a winter home down south. If you would like to know how the purchase of a vacation home for a certain amount impacts other financial goals such as your retirement goals, then speak to your advisor about incorporating this purchase into a financial plan. The following are some key issues and planning ideas you need to be aware of related to owning a vacation home.

### VACATION HOME PURCHASE STRATEGIES

Before committing a large amount of money to purchasing a second property, consider renting in a few desirable areas for a period of time to test the location and neighbourhood. Once you are comfortable with the location and have selected an appropriate property to purchase or build on, the next major decision is how the property should be financed.

If you require a mortgage to assist in purchasing the property, speak to your advisor. The mortgage interest will not be deductible if the property is used strictly for personal purposes. In order to make the loan interest deductible, consider the following two-step strategy:

1. Use existing cash or investable assets to purchase the property
2. Take out a line of credit to purchase income-producing investments

In this case, since the loan was used directly to purchase income-producing investments and not the personal property, the interest on the loan is potentially deductible.

### SUCCESSION PLANNING

In straightforward situations, a person often acquires ownership in a vacation property either solely or jointly with their spouse for control and simplicity reasons. As people get older and no longer actively use the vacation home, people sometimes decide to transfer the property to their children. However, if the transfer of the property is not structured correctly, disharmony amongst family members can occur.



Here are some succession planning strategies to consider related to a family vacation home:

- › If your children will inherit the property and you expect it to significantly appreciate, consider gifting the property to the children today either directly or through an inter-vivos family trust if you wish to maintain control. Although this results in a disposition at market value, triggering accrued capital gains to you today, the future capital gain tax is deferred and probate taxes are avoided. If the property is sold to the children, your capital gain can be spread over five years in some cases.
- › For additional tax deferral, speak to your tax advisor about the advantages and disadvantages of transferring the property to either a Canadian corporation or to a non-profit corporation.

- › If the property value is high and you are over age 65, consider the cost/benefit of rolling it into an alter-ego or joint partner trust today in order to avoid probate taxes related to the property at death (particularly in provinces with high probate taxes).
- › You may leave the vacation home to one or more family members under the terms of your Will. Some of your options include granting one or more children the option to purchase the property, allowing a child to take the property as part of their share in the estate or creating a trust to hold the vacation home under the terms of your Will. In this case, the capital gains taxes can be payable upon the death of the last spouse.
- › Life insurance can be used to pay any capital gains taxes triggered by the disposition of the property when your

estate is settled. It also creates a pool of funds to pay children who are not interested in inheriting the property (alternatively, children who are interested in the property can take out a mortgage to buy out siblings who are not interested). In addition, life insurance can be used to provide the children with the money necessary to pay for the maintenance and expenses related to the property. Since your children will benefit from this insurance coverage, consider asking them to pay the premiums.

- › If more than one child will own the property, they can enter into a co-ownership agreement to determine when and how they can use it, as well as how expenses will be paid.



Regardless of the succession planning strategy chosen, two strategies to minimize capital gains tax on the disposition or deemed disposition of your vacation home, either during your lifetime or at death, are:

1. Ensure that any vacation home renovation costs are tracked as these costs add to the cost of the property for tax purposes and will reduce any future capital gain.
2. Use your principal residence exemption to reduce or eliminate the capital gains tax on the property. However, only one principal residence can be designated per family unit for years after 1981. So if the principal residence exemption is used for the vacation property to minimize the capital gains tax, then it cannot also be used to reduce tax on the disposition of the city home related to years after 1981.

Speak to your advisor if you require more information on vacation home planning.

**U.S. REAL ESTATE PLANNING**

The U.S. government has an estate tax on the fair market value of property located in the U.S., even if it is owned by a non-resident. Furthermore, U.S. states may also impose a probate tax at death based on the value of real estate located in that state. To avoid state probate tax, some cross-border experts will recommend owning the U.S. real estate through a revocable living trust.

U.S. Estate Tax ranges from 18-45% of the fair market value of the U.S. assets; however, there are generous U.S. tax exemptions (indicated in Figure 1) that are available to minimize or potentially eliminate the U.S. Estate Tax.

If your worldwide assets are in excess of the US \$2 million exemption and you have considerable U.S. assets, then there are legitimate strategies to minimize or eliminate the U.S. Estate Tax such as:

<b>FIGURE 1</b>	
For deaths in 2007–2008, Canadians should keep these two thresholds in mind:	
<b>US \$60,000</b>	If your U.S. assets (typically U.S. real estate and U.S. stock) are US \$60,000 or less on death, then there would be no U.S. Estate Tax payable regardless of the value of your worldwide assets.
<b>US \$2 million</b>	If your worldwide estate is US \$2 million or less upon death, then there would be no U.S. Estate Tax payable regardless of the value of U.S. assets. If your worldwide estate is greater than US \$2 million upon death then there could be U.S. Estate Tax on the value of U.S. assets.

- › Purchasing U.S. real estate (and other assets like U.S. stocks) through a Canadian corporation, trust or partnership. There are pros and cons to all three of these structures but in particular you should be cautious about purchasing new U.S. real estate through a Canadian corporation.
- › Having a “non-recourse” mortgage against your U.S. real estate – this special type of mortgage reduces the value of U.S. real estate subject to U.S. Estate Tax dollar for dollar.

For more information, ask your advisor for a copy of the article titled “U.S. Estate Tax”. Your advisor can also assist you with U.S. banking or mortgage services related to owning U.S. real estate.

When it comes to charitable giving, you have a number of different options that can help you achieve your philanthropic goals, while at the same time providing you with some tax relief.

### DONATING SECURITIES

The federal government has introduced several new tax incentives in recent years to encourage charitable giving by Canadians, including the elimination of capital gains tax when you donate publicly listed securities to qualified charities. Not only do you receive a tax break, you also receive a donation receipt equal to the fair market value of the donated security.

For example, due to the donation tax credit, your out-of-pocket cost for making an in-kind donation of a security worth \$100,000 with a cost of say \$40,000 is approximately \$55,000. However, if you sold the security first and then donated the cash, your out-of-pocket donation cost would be \$70,000 due to paying about \$15,000 in capital gains tax.

Furthermore, if a corporation makes an in-kind donation of a listed security to a qualified charity, in addition to the capital gains exemption and the fair market value donation receipt, the corporation can also pay a tax-free dividend to the shareholder equal to the full capital gain.

Your advisor can help you determine which securities would be best suited for donation.

### CHARITABLE FOUNDATION

Another tax-effective charitable giving strategy is setting up your own charitable foundation.

› A private foundation gives you a high level of control and flexibility with respect to charitable giving, and enables you to create an enduring charitable legacy. You can make donations to your own foundation, and you will receive a

donation tax receipt like any other donation. However, to maintain its charitable status, your foundation must meet its annual disbursement quota – 80% of all donations received in the previous year annually, plus 3.5% of the foundation's assets, must be spent on charitable activities or on gifts to qualified donees. There are exceptions to the 80% expense requirement, for example, if the gift was received on the direction that it be held by the foundation for at least 10 years.

While providing a great deal of control and flexibility, a private foundation also involves certain costs and administrative requirements that must be considered. However, as of March 19, 2007, in-kind donations of publicly listed securities to a private foundation are eligible for the full capital gains exemption. In addition, you will receive a donation tax receipt equal to the fair market value of the security at the time of the gift.

› An alternative to a private foundation is making tax-deductible donations to a public foundation. Public foundations are very similar to private foundations in many respects, but involve less cost and administration. Although you do not have outright control now, you can still recommend to the public foundation's directors which charities should receive grants. As of May 2, 2006, in-kind donations of publicly listed securities to a public foundation are eligible for the full capital gains exemption. In addition, you will receive a donation tax receipt equal to the fair market value of the security at the time of the gift.

Speak to your advisor on ways that RBC can help you set up your own foundation.

Depending on your age and needs, there are other creative charitable giving strategies, especially those using life insurance to reduce taxes and significantly increase your charitable contribution after death to your favorite charity. Speak to your advisor if you want more information on charitable giving and legacy planning strategies.



### FAMILY WEALTH MANAGEMENT TIP

In addition to the tax benefits, there are many reasons why a testamentary trust may be advantageous. A testamentary trust provision in the Will can make sense in the following scenarios:

- › Individuals in second marriages
- › Disabled or minor beneficiaries
- › Parent is concerned about spendthrift beneficiaries
- › Parent is concerned about inheritance being accessed by son- or daughter-in-law
- › U.S. citizens
- › Beneficiaries are high-income earners or will receive a large inheritance

For families concerned about intergenerational wealth transfer, a testamentary trust is an indispensable tool. A testamentary trust is a type of trust established through your Will that enables you to give assets to your beneficiaries with certain conditions that you have specified, while providing them with income tax advantages.

In a trust, you specify an amount of money or other property to be held for a specified period for beneficiaries you have identified and on the terms directed by you. For example, you may wish to leave your children a portion of your estate, but you may feel that they should not receive their inheritance until they are old enough to manage it responsibly. Through your Will you would direct your

chosen trustees to hold and invest the inheritance in a trust for your children until they reach the age that you have specified. Alternatively, you can give your trustee full discretion on the amount and timing of trust distributions to the beneficiaries.

Testamentary trusts are generally created with assets passing through one's estate. Therefore, probate taxes (negligible in Alberta and Quebec) will likely have to be paid. However, there will be no probate tax for a properly structured testamentary trust funded with insurance proceeds.

One of the major benefits of establishing a testamentary trust is the annual income tax savings for the surviving beneficiaries. These income tax benefits are not available to beneficiaries who receive outright inheritances. Taxable income earned in a testamentary trust can be subject to the same graduated tax rates as an individual taxpayer. Since the income earned within a testamentary trust can be taxed on a separate tax return at graduated tax rates (although the basic exemption is not allowed), an income-splitting opportunity arises for each beneficiary.

Assume an adult child is in the top marginal tax bracket of approximately 46% (varies by province). Upon the parent's death, this child is expected to receive an outright inheritance of approximately \$500,000. Further assume that this inheritance will be invested by the child and will produce annual taxable income of 5% or \$25,000 per year. The following table compares the after-tax income that will be earned this way with the after-tax income that will be earned if the inheritance is transferred to a testamentary trust instead.

FIGURE 2

	Inheritance transferred to adult child outright	Inheritance transferred to testamentary trust*
<b>Taxable income earned on inheritance</b>	\$25,000	\$25,000
<b>Tax payable</b>	(\$11,500)	(\$5,500)
<b>Trust tax return fees</b>	\$0	(\$500)
<b>After-tax income</b>	\$13,500	\$19,000

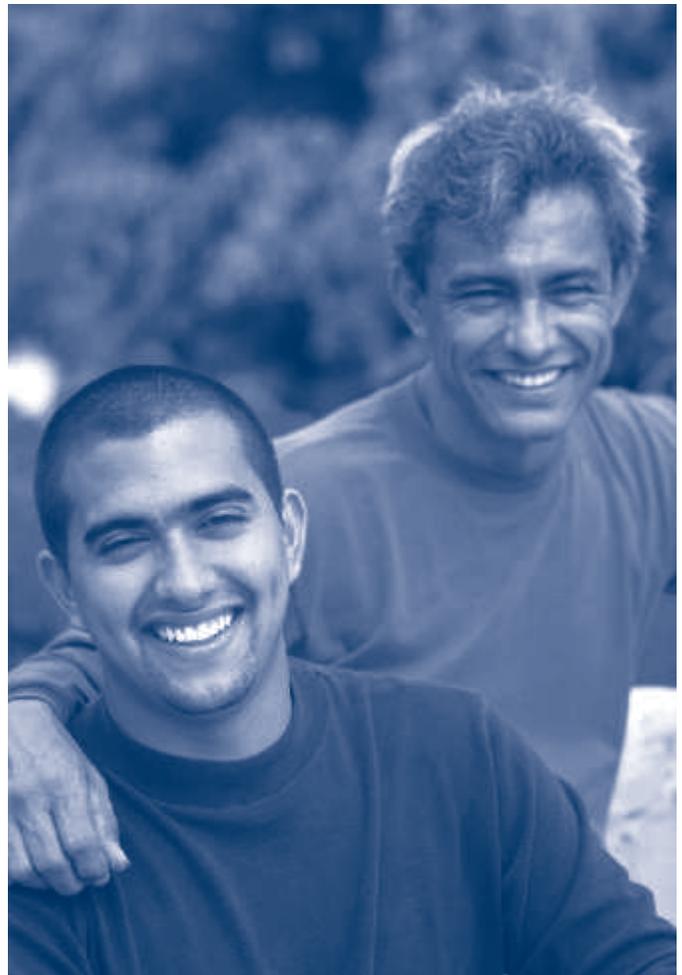
\* It is assumed trustee fees will not be charged

As you can see from Figure 2 above, the adult child enjoys an overall savings of \$5,500 per year (\$19,000 - \$13,500) by earning investment income through a testamentary trust.

If you intend to have your assets pass through your estate so they can fund a testamentary trust, then Joint Tenancy with Rights of Survivorship accounts (not applicable in Quebec) may not be appropriate, and you may also need to restructure beneficiary designations. Furthermore, if you are a high-income earner and you have elderly parents that you know will be providing you with an inheritance, consider speaking to your parents about the benefits of including a testamentary trust provision in their Will.

Speak to your advisor if you are interested in having a Will and estate review from an RBC estate planning specialist. Based on your situation, this specialist can provide Will and estate-planning recommendations such as the suitability of a testamentary trust, vacation property succession planning strategies, the benefits of a secondary Will to avoid probate tax on private company shares, and more.

For more information, ask your advisor for a copy of the article titled “Testamentary Trusts”.



## STRATEGY 9 › FAMILY INCOME SPLITTING

There are two reasons why income splitting is so important in Canada to reduce the family's tax burden:

1. Canada's tax system is based on graduated tax rates
2. Everyone in Canada has a tax-free basic exemption amount

A graduated tax rate system basically means that there is a higher marginal tax rate on taxable income as income increases. Furthermore, each Canadian resident can earn about \$9,000 of taxable income every year tax-free due to the basic personal tax credit. As a result of these two factors, if income can be shifted from a high-income parent to a low-income spouse or child, then the family can realize tax savings up to \$15,000 per year (varies by province). If there are four members in a family, then family tax savings of up to \$45,000 per year can be realized. Due to this amount of potential annual tax savings, families earning a high income should strongly consider family income-splitting strategies.



### FAMILY WEALTH MANAGEMENT TIP

The primary type of income that can be legally split with lower-income family members is investment income (interest, dividends and capital gains) and RSP/RIF income through a spousal RSP.

In order to prevent abusive income-splitting arrangements, the Income Tax Act has income attribution rules. These rules will attribute taxable income back to the high-income family member that actually supplied the capital for investment, thus achieving no tax savings.

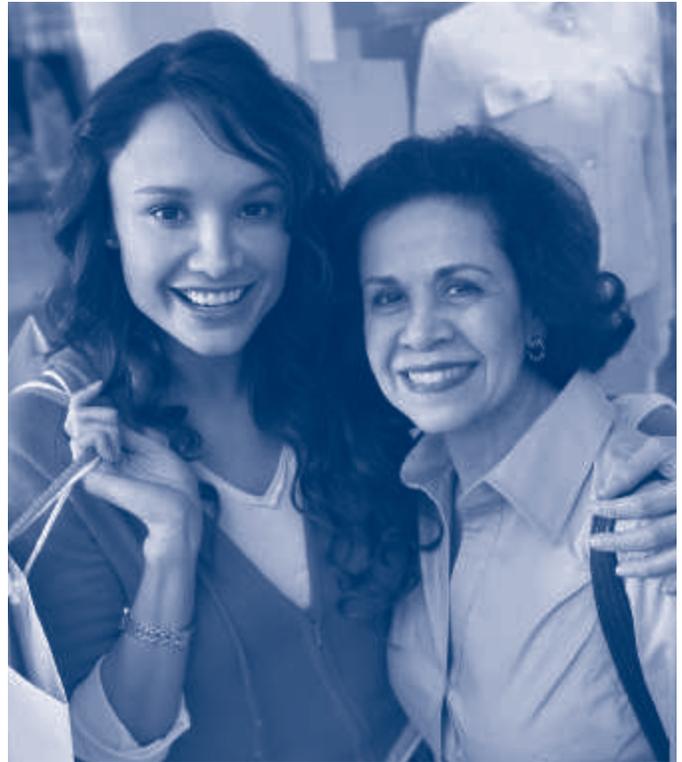
For business owners, you can split income by paying reasonable salaries to lower-income family members based on the services they perform. However, if a low-income spouse or child is not actually working in the family business or their services are minimal, then paying them a salary or bonus that is in excess of the services rendered simply for income-splitting purposes is not permitted.



If you own a Canadian corporation, there are a number of creative strategies to split income with family members. One such strategy, typically done in combination with an estate freeze, is called “dividend sprinkling”. Although there are some attribution rules to consider, this strategy involves paying dividends from the corporation to adult children and spouse shareholders based on the growth of the corporation after the estate freeze. If the spouse or adult children had no other income, then approximately \$30,000 - \$50,000 of tax-free dividends (varies based on province and new eligible dividend tax rules) could be paid to them from the corporation every year if structured properly.

A common investment income-splitting strategy with a low-income spouse, whether you own a corporation or not, is the prescribed rate loan strategy. This strategy results in a high-income spouse loaning capital to a low-income spouse for investment at the CRA-prescribed interest rate in effect at that time. In this case, all future investment income will be taxed to the low-income spouse. However, the high-income spouse must declare the interest on the loan. At the time of writing, the current CRA-prescribed interest rate was 5%, making it difficult to achieve tax savings with a spouse using this strategy.

Gifts of funds to minor children and earning capital gains on the funds is still an effective income-splitting strategy that many high-income parents with low-income children should consider. A child with no other income can earn up to \$18,000 of capital gains every year tax-free due to their basic personal exemption. The capital gain income can then be used for various expenses for the child’s benefit such as private school, camps and clothing. If



you are concerned about gifting monies to your child, then consider loaning the funds to a family trust on an interest-free basis. This will accomplish the same capital gain income-splitting benefit as an outright gift if the trust and loan are set up properly, and you can call back the loan principal any time.

Speak to your advisor if you require more information on family income-splitting strategies.



### FAMILY WEALTH MANAGEMENT TIP

Many business owners tend to procrastinate on implementing a business succession plan since running and growing their business is their priority. According to the Canadian Federation of Independent Business (CFIB), one of the main reasons for failed successions is the lack of adequate time to plan and execute the succession of the business. Therefore, it is never too early to start planning.

Many Canadians have built their wealth by operating a small business or will realize substantial wealth when their private business is sold. In a recent study by the CFIB, approximately 40% of all Canadian entrepreneurs plan to exit their business within five years and 70% within 10 years.

However, the same CFIB study indicates that only one-third of business owners have a succession plan for the transition of their business to the next generation or for the outright sale of the business. Of those that have a succession plan, 82% indicate that the plan helped them plan for their family's future. In addition, other benefits of a succession plan that were cited include:

- › Minimizing tax
- › Improving the financial stability of the business
- › Maintaining family harmony

Here are some key issues that you should consider for a successful business succession plan, along with the tax- and estate-planning strategies:

### CHOOSE YOUR SUCCESSOR WISELY

Communicate openly with your children and determine which child is most interested and most capable to lead your business. In some cases, you may have to choose a non-family member, such as a key employee, to take over your business; or you may need to sell the business outright.

### LET YOUR CHOSEN SUCCESSOR LEAD THE PLAN

Dr. Dean Fowler, a family business consultant, proves that the traditional succession plan where the senior takes the

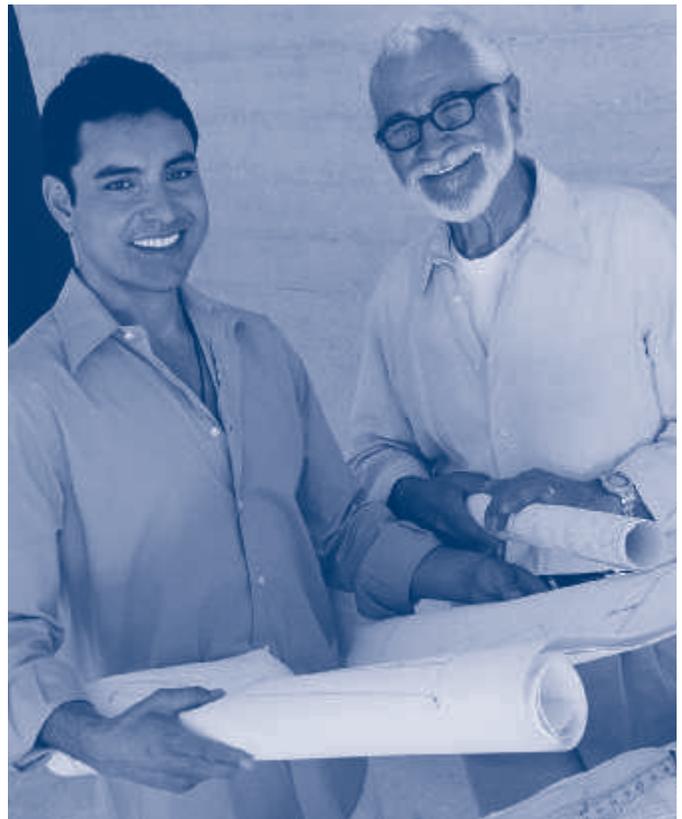
lead, focusing on estate planning, tends to fail. However, plans where the chosen successor takes the lead, focusing on management succession and strategies to buy out the senior, are much more successful.

### GROOM AND TRANSITION OUT

Have your chosen successor gradually take on more responsibility and meet key business contacts well before you transition out. Then be willing to let go of the lead. Have faith in your chosen successor to take over the business.

### HIRE AN EXTERNAL ADVISOR FOR ASSISTANCE

There are professional family business succession facilitators with years of experience to assist your family with the succession plan. Having a neutral third party facilitating the discussion in many cases can help open the lines of communication between the parents and children and lead to a more successful transition.



### FAIR DOES NOT MEAN EQUAL

In order to maintain family harmony, it may make sense to give children who aren't involved in the business fewer assets or other assets such as non-business assets, securities or life insurance proceeds as part of their inheritance, instead of giving them active business shares.

Succession planning should start five to 10 years before your anticipated retirement age. Speak to your advisor if you need assistance on succession planning for your business.



#### COMMON FINANCIAL-PLANNING STRATEGIES WITHIN A BUSINESS SUCCESSION PLAN

- › **Financial plan.** A financial plan for the parent is a critical component of a business succession plan and will determine if the parent has adequate resources to support their retirement lifestyle and highlight which, if any, additional retirement saving strategies (e.g. an IPP) are required.
- › **Estate freeze.** An estate freeze using a family trust is a common business succession and income-splitting strategy that transfers some or all of the future growth of the business to the next generation, helping to minimize and defer tax. Ensure that the estate freeze is flexible enough so that you can possibly reverse the freeze if necessary.
- › **Shareholder's agreement.** A well-drafted shareholder's agreement provides a framework for the smooth operation of a business and addresses business ownership issues when certain triggering events occur (death, disability, retirement, marriage breakdown, and so on).
- › **Insurance.** Appropriate disability, key person and life insurance are imperative to ensure that the business can continue and your family is able to maintain their lifestyle should death or disability occur prematurely. Insurance is also a low-cost solution for funding taxes at death and funding buy/sell agreements.

Families with more financial resources than the average Canadian family face some unique challenges – everything from coping with affluenza to properly transferring wealth to the next generation. But along with these challenges, there are certain opportunities to build and protect wealth, including various legal structures, insurance-based solutions, and investment strategies.

In this guidebook, we have summarized some of the key opportunities that particularly apply to individuals and families responsible for a large amount of “wealth” – which we have defined here as \$1 million or more in investment assets. If you would like more information on any of these opportunities or strategies, either for yourself, your family or someone you know, we would be pleased to help. Please contact your RBC advisor for more information.

For more information, please speak with your Investment Advisor.



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