

Reducing your family's tax burden

Every child or grandchild in Canada that has no other income may be able to earn up to a certain amount of investment income tax-free every year (varies by province). A family trust can be established to take advantage of this annual opportunity and it can be structured so that the parent or grandparent still has access over the monies used to fund the trust. Furthermore, the trust income can be used to pay for various expenses of the child such as private school fees, lessons and camp costs.

This strategy takes advantage of the fact that every person in Canada, regardless of age, has a tax-free basic personal exemption amount (varies by province). This means a family member (regardless of age) that has no other income can earn up to a certain amount tax-free every year, subject to the attribution rules.

You should consider this strategy if:

- You have accumulated significant non-registered assets
- You have children or grandchildren with little or no taxable income
- You are incurring expenses for your children or grandchildren (this is not critical to the strategy)

KEY BENEFITS



- Reduce family income taxes
- Retain access to capital
- Pay for expenses that benefit your children



Strategy in action

The issue: your family's tax bill

There are several ways you can legitimately reduce your family's tax bill, including different income-splitting strategies.

The strategy: income-splitting with a Family Trust

You can decrease the total taxes paid annually by following the steps below:

Step 1: Establish a Family Trust with the advice of a legal and tax professional.† Your spouse alone, or you, your spouse and a trusted third individual are named as trustees and your children are beneficiaries.

Step 2: Make an interest-free loan or prescribed rate loan to the Family Trust. Bear in mind that interest and dividend income earned by the trust will be attributed back to you as

taxable income if an interest-free loan is made – but capital gains will not. If making a prescribed rate loan all investment income, interest, dividend income and capital gains will be taxed in the hands of the beneficiary.

Step 3: Invest the loaned funds. Subject to the attribution rules previously mentioned, the investment income generated should be taxable to your children, either tax-free or at their much lower tax rate. These earnings can then be used to meet your children's particular needs or expenses.

Step 4: A child with no other income can earn approximately \$10,000 of interest income, \$20,000 of capital gains or \$30,000-\$45,000 of Cdn public company dividend (amounts vary by province) tax-free every year. This saves you tax every year per child compared to if you earned the investment income (depending on your top marginal tax rate).

Contact your accountant or tax advisor to understand the tax consequences of the foregoing steps.

† Trust must be structured properly such that subsection 75(2) of the *Income Tax Act* does not apply.

The following example illustrates how a Family Trust can help you reduce your family's tax bill. For this example, assume that:

- You have a non-registered portfolio valued at \$500,000
 - You are in the highest marginal tax rate
 - You have substantial annual expenses for your child
1. You create a formal Family Trust for your children's benefit.
 2. You lend the trust \$500,000 at the CRA prescribed rate of 1% (may be higher depending on when loan was made).
 3. The trust invests the \$500,000 in a balanced portfolio earning interest, dividends and capital gains.
 4. If the trust is set up properly, the investment income is not subject to the attribution rules and can be taxed in your children's hands, if the income is used for their benefit.
 5. You declare the interest on the loan that is paid to you every year from the trust.

Advantages

- Trustees maintain control of funds
- Redeem loan whenever you want to get back loan capital
- Up to a certain amount of investment income can be earned tax free per child per year

Considerations

- Set-up and annual fees as well as additional recordkeeping and documentation
- Liquidating the funds to make the loan could trigger taxes
- Capital losses can only be used by the Trust



*Please contact your Investment Advisor
for more information on the RBC DS Family Trust solution.
As with any tax strategy, make sure you also consult with a qualified
tax professional before taking action.*

Professional Wealth Management Since 1901



This report is not intended as nor does it constitute tax or legal advice, is provided for illustrative purposes only and may not be suitable for your personal financial circumstances or objectives. Readers should consult their own lawyer, accountant or other professional advisor when planning to implement a strategy. The information in this report is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor and your accountant, tax advisor or legal counsel, as applicable. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information and tax rules. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member CIPE. ©Registered trademark of Royal Bank of Canada. Used under licence. RBC Dominion Securities is a registered trademark of Royal Bank of Canada. Used under licence. ©Copyright 2010. All rights reserved. (05/2010) STPDS