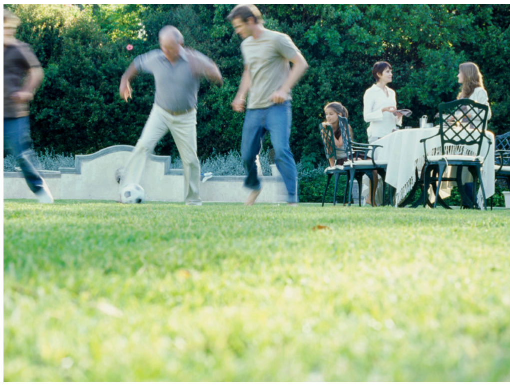

# Reduce Your Family's Tax Burden

## Strategy 9 – Family income splitting

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

- Canada's tax system is based on graduated tax rates
- 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 (varies by province) 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 of 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. When you consider the amount of potential annual tax savings, it makes sense for families earning a high income to strongly consider family income-splitting strategies.

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. The abovementioned income-splitting strategies are permitted by the Income Tax Act as valid strategies.

Your family's overall income tax bill can be reduced through the effective use of income splitting strategies such as the Spousal Loan Strategy, a prescribed rate loan to an RBC Family Trust, Spousal RRSPs and pension income splitting.

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Business owners 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 $10,000 – $50,000 of tax-free dividends (varies based on your province and 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. With this strategy, the high-income spouse loans capital to the low-income spouse for investment at the CRA-prescribed interest rate in effect at that time. In this case, all future investment income is taxed to the low-income spouse. However, the high-income spouse must declare the interest on the loan.

Gifting 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 approximately $18,000 of capital gains every year tax-free (varies by province) due to their basic exemption. The capital gain income can then be used for various expenses for the child's benefit such as private school, camps and lessons.

If you are concerned about gifting monies to your child, then consider loaning the funds to a family trust at the CRA-prescribed interest rate. When properly structured, your children can earn up to $9,000 in interest income, or $18,000 in realized capital gains and even more in eligible Canadian dividends on a tax-free basis (varies by province). With the CRA-prescribed interest rate at lower levels, these tax savings would greatly outweigh the tax on the interest paid to you on the loan.

*Please contact us for more information.*

## Family Wealth Management Tip

RBC offers both family trust and formal trust solutions. These solutions, based on standardized trust deeds, are structured primarily for the purpose of splitting investment income with low-income family members to minimize the overall tax burden on the family. The RBC Family Trust can be used to fund your children's education and expenses while providing a mechanism for income splitting. The RBC Dominion Securities Formal Trust is used primarily for gifting smaller amounts to a beneficiary for income splitting. The main difference between the RBC Family Trust and the RBC DS Formal Trust is that amounts contributed to the RBC DS Formal Trust are irrevocable gifts to a beneficiary, while with the RBC Family Trust, you have the option to loan or gift monies to the trust. Speak to us if you are interested in learning more about the RBC Family Trust or RBC DS Formal Trust.



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