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Strategies and Solutions

Wealth Management Services

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Introducing the RBC DS Family Trust

An exciting Wealth Management Solution for clients with low-income children or grandchildren

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Effective October 29, 2007, the RBC DS Family Trust will be launched to DS to complement our existing suite of wealth management solutions - IPP, RCA, Charitable Gift Program and Agent for Executor. This article outlines the benefits of the RBC DS Family Trust and which of your existing clients or prospects may want to take advantage of it. Note that any references to parent and child in this article equally apply to a grandparent and grandchild.

What is the RBC DS Family Trust?

The RBC DS Family Trust is a fully documented "off the shelf" inter-vivos trust that provides the following three benefits for those clients with low-income children:

1. If the child has no other income, they can earn up to $18,000 of capital gains <u>tax-free</u> every year through the trust. This is because only 50% or $9,000 of the capital gains are taxable which is offset by the child's $9,000 basic personal tax exemption. A parent in the top marginal tax bracket would pay tax of about 20-24% on capital gains depending on their province of residence.
2. The parent is permitted to <u>loan</u> cash to the RBC DS Family Trust so they will never lose access to the loan capital. The minimum initial loan amount is $50,000.
3. Investment income earned in the trust can be used to pay for expenses that directly benefit the child (e.g. private school tuition, post-secondary education costs, lessons, camps, etc).

Which clients would be interested in the RBC DS Family Trust?

The following types of clients would be interested in setting up a RBC DS Family Trust:

- High income executives, professionals and business owners with minor children or low-income adult children
- Parents with children in private school or in expensive sports or lessons
- DS Investment Advisors with minor children
- Parents with little in education savings or that have started an RESP late
- Grandparents who want to provide funds to grandchildren

How does the RBC DS Family Trust differ from the RBC DS Formal Trust?

There are a few differences but the primary difference between the RBC DS Formal Trust and the RBC DS Family Trust is the fact that the RBC DS Family Trust permits the parent to <u>loan</u> cash to the trust with or without interest, whereas any monies contributed to the RBC DS Formal Trust are considered <u>irrevocable gifts</u>.

The loan is a demand loan and this feature of the RBC DS Family Trust allows the parent full access to the loan capital at anytime by calling back all or a portion of the loan. As a result of this "safety feature", the parent is likely more comfortable to fund greater amounts to the RBC DS Family Trust compared to the RBC DS Formal Trust. Greater capital in the RBC DS Family Trust will invariably allow the trust to generate more capital gains that will be subject to little or no tax. For example, to create $18,000 of annual tax-free capital gains in the name of the child, assuming annual expected realized capital gains of 6%, the parent would have to fund $300,000 to a trust [$300,000 x 6% = $18,000]. Most parents are not comfortable making an irrevocable gift of $300,000 to the RBC DS Formal Trust which their child would have full rights to at age of majority. However, <u>loaning</u> $300,000 to the RBC DS Family Trust which the parent can call back anytime is a strategy that many parents would consider in order to create tax-free capital gains.

The RBC DS Family Trust Options

There will be two RBC DS Family Trust options:

i) Age 40 Family Trust

ii) Discretionary Family Trust

<u>Age 40 Family Trust</u>

The Age 40 Trust is used if the client wants greater control over the income that was earned in the trust. That is, all income earned in the Age 40 Trust that is not directly paid to the beneficiary or used to cover expenses for the beneficiary by the age of 21, can remain within the trust until as late as the beneficiary reaches age 40 (however it can be paid to the beneficiary earlier if desired). The beneficiary has full rights to any income earned after age 21.

Only one beneficiary per trust is permitted under the Age 40 structure.

<u>Discretionary Family Trust</u>

The Discretionary Trust allows multiple beneficiaries per trust. The trustees have full discretion to pay the income earned in the trust to any beneficiary and in any amount. However, if the income earned was not either paid directly to the beneficiary or used on expenses that benefit the beneficiary, then the beneficiary would have full rights to that income immediately.

Who can be the trustees?

There can be either one trustee or three trustees. For tax reasons, the parent loaning the monies should not be the sole trustee or a beneficiary. If one parent is the lender the other parent can be the sole trustee. Alternatively, both parents and a trusted third individual can be three trustees where the decisions are made by a majority rule process.

What are the income attribution rules for the RBC DS Family Trust?

If monies are loaned to the RBC DS Family Trust on an interest-free basis, then interest and dividends will be attributed back to the lender parent. However, capital gains can be taxed in the hands of the beneficiary child without the attribution rules applying if the trust is structured correctly.

If monies are loaned to the RBC DS Family Trust at the current Canada Revenue Agency (CRA) prescribed rate of 5%, then there will be no attribution on any interest, dividends or capital gains earned, however the trust will have to pay the lender parent 5% interest on the loan and the parent will have to pay tax on this interest at their marginal tax rates.

Since the current CRA prescribed rate of 5% is high, it may be difficult to achieve family tax savings. Therefore, most parents will likely want to loan monies to the RBC DS Family Trust on an interest-free basis and try to primarily earn capital gains.

Investment strategies for RBC DS Family Trust

Any investment option that the trustees deem appropriate will be permitted in the RBC DS Family Trust. If the loan to the trust is on an interest-free basis, then capital gains will have to be earned to avoid the attribution rules. Therefore, you should have an investment risk discussion with the client of earning capital gains. There will be an article in a future edition of the Bulletin that will provide details on some potential investment strategies you could consider to generate capital gains in the RBC DS Family Trust.

I heard the trust can be used to pay for a child's expenses?

Yes this is possible as long as the expense directly benefits the beneficiary. The CRA has indicated that expenditures made for the child's benefit by the trustee can include amounts paid for the support, maintenance, care, education, enjoyment and advancement of the child, including the child's necessaries of life. If the trust income is used to pay for expenses that benefit the child, it is important that the expenses be documented properly and receipts be retained.

Although there is no official list from the CRA of expenses that qualify as directly benefiting the child, the following expenses may qualify.

- Private school tuition
- Post-secondary school fees
- Lessons
- Camps
- Sports equipment
- Gifts

Using the trust income on ordinary household expenses or expenses that benefit someone other than the beneficiary will result in adverse tax consequences.

Parents and trustees should speak to their legal or tax advisor for further advice and guidance on this matter before using the trust income to pay for the children's expenses.

What are the fees associated with the RBC DS Family Trust?

There are no set up fees charged by RBC DS for establishing a RBC DS Family Trust. However, it is strongly recommended that clients sit down with their legal and tax advisors to review the RBC DS Family Trust legal agreements and discuss trustee responsibilities before opening an account. Therefore, there will likely be professional fees incurred at the time of set up.

There will be annual fees associated with the RBC DS Family Trust as follows:

i) Investment fees

ii) Tax return fees

iii) RBC DS annual administration fee

<u>Investment fees</u>

Investment fees that the trust pays will either be commissions on the purchase and sale of investments and/or investment management fees if a managed account program is used.

Tax return fees

A T3 trust tax return will be required for the RBC DS Family Trust. RBC Royal Trust has agreed to prepare the T3 trust tax return for the RBC DS Family Trust for a fee of $350 + GST per trust tax return. This fee is subject to change. Alternatively, the client's accountant can prepare the T3 trust tax return.

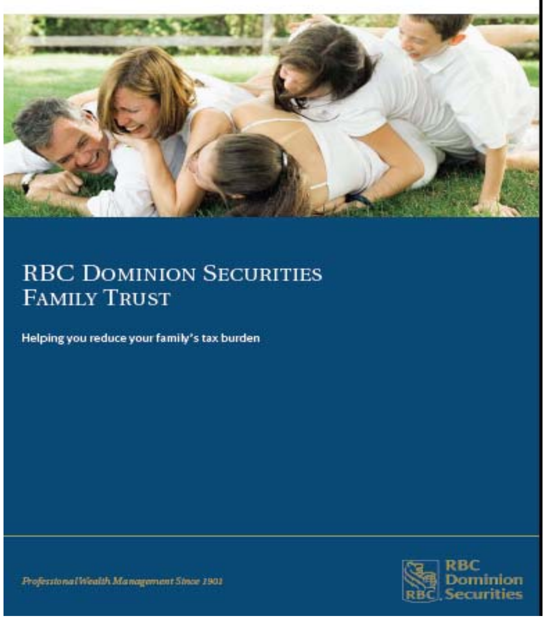
The beneficiaries of the trust may also be required to file a T1 personal tax return depending on the type and amount of income allocated to them from the trust in addition to any other sources of income. The client's accountant will be responsible for the preparation of the beneficiary's T1 personal tax return and will be responsible for determining the amount of income on the T3 slip issued from the RBC DS Family Trust that is attributed to the lender parent or grandparent, if any.

RBC DS annual administration fees

The annual RBC DS administration fee for the RBC DS Family Trust is $250 + GST. If RBC Royal Trust is used to prepare the T3 trust tax return then a $100 rebate on the administration fee will be provided thus reducing the annual administration fee to $150 + GST. The annual administration fee is subject to change.

Client marketing material

The Business Development and Marketing department is currently finalizing a client brochure that you can provide to existing clients and prospects that may find the RBC DS Family Trust appealing. In the mean time, you can provide this Bulletin article to clients and prospects.



How do I open a RBC DS Family Trust account?

The decision to open a Family Trust requires significant commitment by the trustee(s). **We strongly recommend that clients (both lender and trustees) review all trust and loan documents with their legal and tax advisors before establishing a RBC DS Family Trust. It is also recommended that the trustee(s) consult with their tax and legal advisors to discuss the responsibilities of a trustee and recordkeeping requirements.**

Internal materials:

Training guides are available to assist with the account opening process and the ongoing account administration on the RBC DS Family Trust. They include:

i) Part 1: Income Splitting with Children: Is it appropriate for your client?

ii) Part 2: Account Opening Process

iii) ClientSource RBC DS Family Trust Account Opening Guide

iv) Part 3: Ongoing Account Administration / Account Tracking

v) Frequently Asked Questions (FAQ) – Client Friendly

Please refer to the RBC DS Family Trust site on AdvisorNet to access the training materials: http://advisornet.rbcds.com/category/1,1080,FTA-B10,00.html.

Client materials:

i) Client Brochure – Coming Soon

ii) RBC DS Family Trust Account Documentation

iii) Frequently Asked Questions (FAQ) – Client Friendly

Questions?

If you have questions related to account set up or administrative related questions, please contact the Managed Products Helpdesk. If you have technical tax or legal related questions on the RBC DS Family Trust then please contact the Wealth Management Services team. **Note that these are internal only teams that can only be accessed by RBC DS advisors.**