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WEALTH MANAGEMENT
Wealth and Money Management
Strategies and Solutions

Wealth Management Services

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Investment Holding Company Planning

Summary of July 19, 2007 HNW Conference Call

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As a follow-up to the July 19, 2007 HNW conference call, this document captures the key messages and action items discussed on the call. To listen to the recording of the call go to AdvisorNet>Wealth Management Services>High Net Worth.

Key messages

a) Reasons why Holdco set up: There are a number of reasons why a client may have a Holding Company (Holdco) such as for creditor protection for surplus assets in an Operating company (OPCO), part of an estate freeze or estate plan, to avoid US Estate tax or for limited income splitting possibilities. Historically, a Holdco was also used to take advantage of lower corporate rates when compared to the personal tax rates. However, over the last few years, the personal tax rates have dropped and in most provinces, there is a slightly higher tax rate on investment income earned inside a Holdco vs. earned personally.

b) Taxation of Holdco income: Investment income earned in a Holdco is taxed differently depending on the type of income. Interest and foreign income are subject to tax at the highest corporate rate (45-52% depending on province) which is higher than the rate applicable to active business income (16-38%). Only 50% of capital gains are taxable in a Holdco (similar to individuals). Canadian dividend income is taxed at a flat 33.3% in a Holdco. So, this means that both capital gains and Canadian dividends are taxed lower in Holdco compared to interest income and foreign dividends which similar for individuals. A portion of the taxes paid by the corporation on investment income is refunded when a taxable dividend is paid out to the shareholder. The corporation is not subject to the graduated personal marginal tax rates.

Note that the above tax rates for investment income earned in a Holdco also applies to investment income earned in an OPCO.

Canadian dividend income earned in a Holdco is subject to a flat 33.3% tax that is fully refundable when a dividend is paid out to the shareholder. The refundable tax is $1 of tax refund to the Holdco for every $3 of dividends paid out of the Holdco to the shareholder. A corporation would not be subject to the dividend tax credit and would not gross up the dividend received in the same manner as an individual. Based on the current personal and corporate tax rates, receiving a Canadian dividend inside a corporation would result in a prepayment of tax since the flat corporate tax rate of 33.3% is higher than the personal tax rate on Canadian dividend income. As a result it is advisable that when Canadian dividend income is earned inside a corporation, the same amount should be paid out to the shareholder.

c) Withdrawing money from Holdco: There are a number of methods to get funds out of a corporation including the payment of a taxable dividend or a tax free dividend from the Capital Dividend Account (CDA). A shareholder loan to the corporation may be paid back without any tax implications or a share redemption may be made with possible tax implications.

d) Holdco drawbacks: Some of the drawbacks for having a Holdco are the professional costs associated with setting up the corporation and the fees for preparing the annual corporate tax return. The disadvantages from a tax perspective are that there is no tax saving to earning investment income inside a corporation and shares of a Holdco would not qualify for the capital gains exemption.

Action items

Identify clients with a Holdco where one of the following planning points may apply

- Consider the following asset allocation tips to maximize use of Holdco:
  - Payout Canadian dividend income earned in Holdco out to shareholder in year earned
  - Hold US stocks in Holdco vs. personally to avoid US Estate Tax
  - If considerable fixed income is generated in Holdco, consider tax exempt life insurance or if over age 65 use a corporate insured annuity.
- Consider paying out CDA balance when significant capital gains are triggered or prior to tax loss selling. Communicate with accountant subsequent to triggering gains or prior to triggering losses.
- If making charitable donations, consider using the Holdco to take advantage of CDA balance and to take advantage of high corporate tax rates.
- Consider use of multiple Wills to reduce probate fees in provinces where applicable.

RBC introduces industry-leading consolidated reporting

Today, most holding company owners and high-net-worth investors hold significant diversified portfolios in several brokerage accounts. This investment strategy burdens investors and their accountants with reviewing multiple statements and reports in a variety of currencies. This paperwork is not only time consuming, but can be costly for your clients.

Unlike traditional statements which report activity for each individual DS account, consolidated reporting combines transactions from multiple investment accounts. Furthermore, you can now provide your client with consolidated reports including investment account transactions and details from a number of different external money managers who custody their assets with Dexia Investor Services as well as Private Counsel.

The opportunity

All companies are required to prepare a set of financial statements and tax returns. As a result, accountants must spend a significant amount of time and effort in summarizing a multitude of transactions from brokerage statements. Many accountants will manually re-enter individual transactions into an accounting package or spreadsheet application. This detailed recording of activity, in a variety of foreign currencies, can be frustrating and very time consuming for accountants and costly for your clients.

Using RBC's consolidated reporting service will add value to your client relationship as you can provide your client with improved statements designed to meet their accounting and tax reporting needs. Furthermore, an accountant's bookkeeping time and effort can be considerably reduced ultimately saving your client money.