Tax planning strategies for high income earners

Depending on your province of residence, you may be subject to tax at a rate of 50% or higher when your income exceeds $200,000. This article highlights a non-exhaustive list of tax minimization strategies to consider with your professional advisor. The use of these strategies will vary based on personal circumstance. As such it is crucial to check with your qualified tax advisor prior to implementing any of these strategies.

The federal government has proposed changes which target private corporations. Generally, effective for 2018 and later taxation years, the government has proposed to limit income splitting to family members receiving “reasonable” compensation from a private corporation. The proposed measures extend the tax on split income rules (often known as “kiddie tax”) to adults.

The government also intends to eliminate the tax advantage of investing undistributed earnings from an active business in a private corporation. Details of this proposed measure will be released in draft legislation as part of the 2018 federal budget. If enacted, this measure may result in a disincentive for investing passively within a corporation.

The strategies discussed in this article may be affected by the proposed measures. If you are an owner of a private corporation, you should consider the potential impact of the proposed measures and discuss the implications with your qualified tax advisor.

Tax minimization strategies for individuals

Income splitting with family members

Family income splitting is a fundamental tax planning strategy but many Canadians are not taking advantage of simple income splitting opportunities that have already been acknowledged by the Canada Revenue Agency (CRA) as acceptable. If you have a low-income spouse or low-income children or grandchildren, you may wish to consider setting up a prescribed rate loan for income splitting.

It is important to understand the impact of the ‘attribution’ rules in the Income Tax Act if you plan to income split with your family members. These rules have the effect of attributing taxable income back to the family.
By investing in an RRSP, you can deduct the amount of your RRSP contribution from your taxable income, up to your annual RRSP deduction limit, thereby reducing the taxes you will have to pay.

member who supplied the capital for investment so that in effect, no tax savings are achieved.

The attribution rules may be avoided by making a prescribed rate loan to a properly structured family trust or directly to a spouse using a formal loan agreement. The prescribed rate is set by the CRA quarterly. The rate in effect at the time the funds are loaned should be used and will apply to the loan so long as it remains outstanding. The family trust or your spouse pays you annual interest on the loan, which may be deductible to them. You must include the interest you receive as your income. Provided the rate of return on investments is higher than the interest paid, and this strategy is properly implemented, the tax savings should more than compensate for the tax you pay on the interest you receive from the loan.

Family trust
If you have children, grandchildren, nieces or nephews with little or no income, you may wish to consider establishing a family trust to shift investment income that would otherwise be taxed in your hands at a high marginal tax rate, to the hands of your low-income family members. If properly structured, income earned in the trust and paid or made payable to the trust beneficiaries may be taxed at their marginal tax rate (subject to the attribution rules). Each person can receive certain amounts of income tax-free annually due to the tax credits that are available to individuals. The income earned in the family trust can also be used to pay for your child’s expenses (private school fees, lessons, gifts, etc.), which you may have been paying all these years with your after-tax dollars. Parents and trustees should speak to their legal or tax advisor for further advice and guidance on this matter before using trust income to pay for a child’s expenses.

Spousal loan
If you have a low-income spouse, consider establishing a spousal loan to shift investment income and capital gains to them. This will allow you to take advantage of your spouse’s lower marginal tax rate. The strategy involves you transferring funds to your low-income spouse through a formal loan arrangement at the CRA prescribed interest rate. Your spouse is then able to earn investment income on these funds and pay taxes at their lower marginal tax rate.

Invest in Registered Accounts
Tax-Free Savings Account (TFSA)
In addition to investing in a TFSA of your own, consider making a gift to your adult family members or spouse to enable them to contribute to a TFSA. All the investment income in the TFSA grows tax-free and future withdrawals are not taxable. Further, there will generally be no income attribution, regardless of who funds the account. If gifting to your spouse, attribution will not apply so long as the funds remain invested in the TFSA.

Registered Retirement Savings Plan (RRSP)
By investing in an RRSP, you can deduct the amount of your RRSP contribution from your taxable income, up to your annual RRSP deduction limit, thereby reducing the taxes you will have to pay. In addition, funds in an RRSP grow on a tax-deferred basis. The investment income and capital gains generated in the plan are not subject to tax until you make a withdrawal in the future.

You may also want to consider contributing to a spousal RRSP for your low income spouse to equalize future retirement income. In doing this, the high income spouse utilizes their RRSP contribution room when making a contribution and is able to claim the deduction on their return. The RRSP/RRIF withdrawals will be
It is important to be aware of the tax credits and deductions that may be claimed by you on your tax return to ensure maximum tax savings.

Registered Education Savings Plan (RESP)
Are you planning on paying for your child’s post-secondary education? If so, consider setting up an RESP. While your contributions will be made with after-tax dollars, the RESP will benefit from tax-deferred growth and government grants. When your child attends a qualified post-secondary education program, and withdrawals are made, the income earned in the plan may be taxed in your child’s hands presumably at a lower tax rate than your own.

Choose tax-efficient investments
Flow-through shares
A flow-through is a type of tax-advantaged investment designed to encourage investing in resource companies that are engaging in exploration and development in the mining, oil and gas, and renewable energy and energy conservation sectors. If structured properly, the resource company “renounces” or “flows through” the expenses it incurs to you which you can then deduct personally on your tax return. The maximum amount you can deduct is the amount you paid for the investment. You may apply the deductions against all sources of income, thereby reducing your net income. It is very important to consider the quality of the investment, and not just the potential tax write-off.

Tax-exempt life insurance
If you have surplus assets that you plan to pass on to your heirs then you should probably consider how these assets are invested. By simply investing the assets in a non-registered account, the income earned will be exposed to your high marginal tax rate. At death, your assets often trigger significant tax obligations, which are frequently met by liquidating the assets of your estate. If you own substantial assets that you want to protect from taxes, tax-exempt insurance can preserve the value for your beneficiaries. This type of permanent life insurance benefit can cover your tax obligations and leave your estate intact.

Permanent life insurance policies (whole life and universal life) provide both life insurance protection and a savings vehicle. Under the federal Income Tax Act, assets accumulate within a tax-exempt life insurance contract free of annual accrual taxation. When you pass away, any proceeds of the policy are distributed to your beneficiaries on a tax-free basis outside the scope of your estate, bypassing its associated costs. Speak to a life-insurance licensed representative to determine if you have an insurance need and/or to find out how tax-exempt insurance may work for you.

Maximize tax credits and deductions available to you
It is important to be aware of the tax credits and deductions that may be claimed by you on your tax return to ensure maximum tax savings. One tax credit that is often overlooked is the medical expense tax credit. You may wish to keep a running tally of the eligible medical expenses paid for out of pocket as well the receipts, so that you can more easily determine whether you qualify for the credit. These types of expenses accumulate
Making a charitable donation is one of the ways that you can significantly reduce the personal tax you pay. As an alternative to cash, consider donating publicly listed securities in-kind to qualified charities. Any capital gain realized as a result of the donation will not be subject to tax. You will also receive a donation tax receipt equal to the fair market value of the security at the time of the donation. This can help reduce your total taxes payable and costs you less than if you were to donate the proceeds to the charity.

If you have thought about leaving a legacy for charitable purposes but are unsure about the best way to accomplish this, speak to your RBC advisor on the benefits of setting up your own charitable foundation through the RBC Charitable Gift Program.

Speak with your qualified tax advisor as well to ensure that you are claiming all tax credits and deductions available to you such as the childcare expenses, disability tax credits, pension income credit, non-reimbursed union and professional dues, other employment expenses etc.

Contributions made by the employer to an RCA are not considered taxable income to you. This may reduce the portion of your income that is subject to the higher tax rates. Employers are generally able to deduct 100% of the contribution they make and, at retirement, distributions you receive from the RCA will be fully taxable as other income. The RCA therefore allows you to defer tax on the amounts contributed to the RCA by your employer. Payments from an RCA in some instances may be considered eligible pension income and you may be able to income split these payments with your spouse when you reach age 65. In addition, an RCA may save you tax if you expect to be in a lower tax bracket or a non-resident of Canada at the time you receive distributions.

Other employment benefits
Consider speaking to your employer about increasing your non-taxable benefits in exchange for salary, bonuses or other taxable benefits. Non-taxable benefits include private health services plans, registered pension plans such as an Individual Pension Plan, training or education expenses, home computers and internet, scholarships and childcare as long as certain conditions are met.

Review your compensation package with your employer
Retirement Compensation Arrangement (RCA)
If you are an executive and are in a position to negotiate how your compensation package is structured, consider the pros and cons of having your employer establish an RCA as a component of your compensation. An RCA is a type of employer sponsored and funded retirement savings arrangement which permits larger contributions than would be possible with other registered plans.
An IPP is an alternative to an RRSP that enables your company to make larger tax-deferred annual contributions than would be permitted to an RRSP.

Tax residency planning
While moving to a lower tax jurisdiction is not a decision that should be taken lightly, it may be beneficial for you to consider this strategy if you have ties (e.g. family or a vacation property) in another province. The provincial tax rates to which you are subject are based on your province of residence on December 31 of the taxation year. Residency status is always a question of fact and is based on the residential ties you have with each province. You should speak with a qualified tax advisor to determine your province of residence and whether this strategy will be beneficial to you.

Tax minimization strategies for business owners
Establish an Individual Pension Plan (IPP)
An IPP is a registered defined benefit pension plan sponsored by an employer, usually for one individual and, in some cases, also for that individual’s spouse if the spouse also works for the company. An IPP may be ideally suited for individuals over the age of 40 who earn a substantial amount of employment income.

An IPP is an alternative to an RRSP that enables your company to make larger tax-deferred annual contributions than would be permitted to an RRSP. These contributions are tax deductible to your corporation and not taxable to you. This allows you to defer your compensation and have it grow in a tax-deferred registered plan until your retirement (when you will potentially be in a lower tax bracket). In addition, you may be able to split your IPP retirement benefits with your spouse, which may further lower your family’s overall tax bill.

IPPs may provide a number of additional advantages. Contributions increase with the age of the plan holder allowing for more asset accumulation in the plan. If the investment earnings in the plan are lower than expected, it may be possible to make additional contributions to address the deficit, depending on your province of residence. Assets in an IPP may also be creditor protected in certain circumstances.

Withdraw cash from your corporation tax-efficiently
If you need the corporation’s surplus funds for personal-use, there are many ways to withdraw those funds, each with different tax implications. Consider using the following strategies first to get funds out of a corporation tax-free or on a tax-deferred basis before making a taxable salary or dividend withdrawal:

- Reimburse yourself for business expenses you paid personally;
- Repay amounts owed to you by the corporation;
- Pay a capital dividend;
- Reduce the amount of paid-up capital on your shares by returning the paid-up capital to you as tax-free return of capital.
Keep more money in your corporation
As a business owner, you may choose the amount you withdraw from your corporation. The withdrawal can be categorized as a salary or dividend which is taxable to you personally. Because you must pay personal tax on top of the corporate taxes already paid on your business earnings, it may make sense for you to withdraw only enough compensation to fund your current year expenses. You can retain any surplus funds inside the corporation and invest those funds. By minimizing the amount you withdraw from your corporation, you can defer the personal tax payable on your business income which may increase your investment capital.

Pay family members a reasonable salary
If you are self-employed and your spouse and children help out in the business, consider paying them a reasonable salary. Salaries or wages paid to them will reduce your net business income which is otherwise taxable to you personally. This is a great income-splitting strategy that may help your family save tax if your children or your spouse are in a lower tax bracket than you. In addition, a salary or bonus is considered earned income for the purposes of generating RRSP contribution room and pensionable earnings for the Canada Pension Plan (CPP)/Quebec Pension Plan (QPP).

Pay dividends to adult family members
Consider paying dividends from corporate earnings to your spouse and adult children who are shareholders. If they are not shareholders, consider restructuring your business to incorporate your family members. This will allow you to split some of your business income with them and reduce your taxable income.

Unlike salaries, your family members do not have to work in the business to be able to receive a dividend. By making your family members shareholders of your business, you will have more flexibility in income splitting with them. Further, Canadian dividends are taxed at a lower rate than salary.

However, you should be aware that dividends will not create RRSP contribution room or CPP/QPP pensionable earnings. In addition, dividends that are paid out to benefit related minor children are taxed at the highest marginal tax rate under the “kiddie tax” rules.
Plan now

Tax planning should be an ongoing, dynamic process so that you do not overlook opportunities to minimize tax. Whether you are able to take advantage of the tax planning opportunities discussed above, or pursue other tax planning strategies, advance planning is the key to success. Now is a good time to review your circumstances to address changes to the law and to your personal situation.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.
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