Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Tax and estate planning for RBC executives

Please contact us for more information about the topics discussed in this article.

As an executive at RBC, most of your compensation is taxable as employment income which is fully taxable. It is not possible to split this type of income with your family members but there are still income tax and estate planning strategies you can implement to reduce your family's overall tax bill and to help you build your wealth. This article addresses some of these strategies.

The information in this article assumes you are a resident of Canada and you are not a U.S. person (U.S. citizen, green card holder or resident). If you are a U.S. person, please consult with a qualified cross-border tax advisor to determine any U.S. income tax and estate tax consequences to you.

Family income splitting

Individuals are subject to tax at graduated tax rates; the higher your income, the higher your marginal tax rate. As a result, it's generally advantageous for a high-income earner to split income with a low-income spouse or common-law partner (for the remainder of this article, the term "spouse" includes a common-law partner), children or other family members to take advantage of their low marginal tax rates. However, there are attribution rules that may prevent some income splitting arrangements. The following are some income splitting strategies that may allow you to reduce the total tax bill of your household.

Income splitting with a spouse

If you gift funds to your spouse to invest, any income or realized capital gains they earn on those funds are attributed back to you and taxed in your hands at your marginal tax rate, which may be higher than your spouse's. If you loan funds and charge no interest or a very low interest rate, the attribution rules may also apply. These attribution rules may not apply if you loan funds to your spouse and charge interest on the borrowed funds at the Canada Revenue Agency (CRA) prescribed interest rate, commonly referred to as a prescribed rate loan. Based on these rules, here are some strategies you may consider to split income with your lower-income spouse.

- Consider making a formal loan to your spouse, either directly or through a family trust. A direct loan is less costly and simpler than using a family trust. This strategy is sometimes referred to as the spousal loan strategy. You would have to charge interest on the loan at the CRA prescribed rate, and meet other requirements, to avoid the attribution rules. Your spouse may invest the borrowed funds in portfolio investments and have the income earned or capital gains realized on these funds taxed at their lower marginal tax rate. Essentially, this allows you to shift income and capital gains to your lower-income spouse. However, you would have to pay tax on the interest income you earn on the loan at your higher marginal tax rate. Therefore, a cost/benefit analysis needs to be done to ensure this strategy makes sense for your family.
- If your spouse has a source of funds, other than from you, have your spouse invest their funds, since the income they earn will be taxed at their lower marginal tax rate. Use your earnings to pay for the family's living expenses. You may even pay your spouse's tax liability to allow your spouse to save their funds and use them for investment purposes.
- If you gift funds to your spouse, all investment income (interest, dividends and realized capital gains) earned on those funds will be attributed back to you. However, if your spouse transfers the interest and dividend income (this does not include realized capital gains) they earn on the gifted amount every year to a separate account, all future investment income and realized capital gains they earn in this second account will not be attributed back to you. This strategy, commonly referred to as the income-on-income strategy, involves more recordkeeping and may take time to achieve meaningful tax savings.

Income splitting with children

If you gift funds to your minor children or grandchildren to invest in portfolio investments, any interest or dividend income they earn on those funds are attributed back to you and taxed in your hands at your higher marginal tax rate. Any realized capital gains they earn are taxed in their hands. In the year they turn 18, the attribution rules no longer apply. Therefore, you can gift funds to any of your adult children or grandchildren without worrying about attribution.

If you loan funds and charge low or no interest, the attribution rules may also apply to interest and dividend income, but not to capital gains, earned on the borrowed funds, regardless of the age of the child. These attribution rules may not apply if you loan funds to your child or grandchild and charge interest on the borrowed funds at the CRA prescribed interest rate. You would have to pay tax on the interest income you earn on the loan at your higher marginal tax rate.

If your spouse has a source of funds, other than from you, have your spouse invest their funds, since the income they earn will be taxed at their lower marginal tax rate. Use your earnings to pay for the family's living expenses.

Based on these rules, here are some strategies you may consider to split income with your lower-income children or grandchildren.

- Consider establishing a trust for the benefit of your children and/or grandchildren. You can fund the trust using a prescribed rate loan at the CRA prescribed rate. You would need to include the interest earned on the loan in your income, but hopefully the funds invested in the trust would earn sufficiently more than the interest charged to make the strategy worthwhile. The annual interest, dividends and realized taxable capital gains can then be paid out to the beneficiaries, used for their benefit or made payable to them so that it's taxed in their hands at their lower marginal tax rates, assuming the trust is properly structured. If they have no other source of income or are in a very low tax bracket, these funds may attract little or no tax. The income of the trust can be used to cover expenses that directly benefit the beneficiaries, such as private school tuition, lessons, camp, etc. These are the types of expenses you would have to pay with your after-tax funds that were taxed at a very high marginal tax rate.

Using a prescribed rate loan, rather than a gift, provides more flexibility in the type of investment income the trust can earn, instead of limiting the trust to just earning capital gains where the beneficiaries are minors. Another benefit of loaning monies to a trust is that you may call the loan and get your capital back. A trust allows for more control over the management and use of the funds and allows this strategy to be implemented where minors are involved. If your children or grandchildren are adults, you may instead consider loaning funds directly to them at the CRA prescribed rate, similar to the spousal loan strategy discussed previously.

- If your child qualifies for the disability tax credit, you can use a Registered Disability Savings Plan (RDSP) to save for the long-term financial needs of your child in a tax-sheltered environment. Up to a lifetime maximum of $200,000 can be contributed to an RDSP for the benefit of a beneficiary with a disability. Once the funds are in the RDSP, they become the property of the beneficiary and cannot be returned to you. It is also possible to earn grants from the government for contributions to an RDSP, depending on the age of the beneficiary.

- To save for your child's post-secondary education, consider contributing at least $2,500 per year per child to a Registered Education Savings Plan (RESP) to maximize the available government grants. All of the income earned, capital gains realized and grants received in the RESP are tax-sheltered until they are paid out to the beneficiary, at which time they are taxed in their hands at their lower marginal tax rate. If you have surplus cash, it may be worthwhile forgoing the government grants and contributing the lifetime maximum of $50,000 per child upfront for maximum tax-sheltered growth.

Estate planning

You should have a Will and a Power of Attorney. They should be reviewed regularly to ensure they are valid and reflect your current situation and wishes. If you don't have a Will, your assets may not be distributed as you would have wished or intended. Also, if you have made any beneficiary designations on registered plans or insurance policies, ensure that they are up to date and reflect your estate planning objectives.

Consider how you want to leave your assets to your beneficiaries. Do you want to leave the assets outright to your beneficiaries or do you want a trusted, capable person(s) to manage and maintain some control over your estate assets? A common tool that can be used is a testamentary trust.

Testamentary trust

In certain circumstances, you may want to use a testamentary trust to hold your assets after your death instead of transferring them outright to your spouse or children. A testamentary trust allows you to determine how your assets will be managed and by whom after your death and to control the distribution of your assets to your beneficiaries. This may help you create solutions to more complex family situations.

For example, if you're in a second marriage and you have children from your first marriage, upon your death, you may transfer your assets to a testamentary trust for the benefit of your surviving spouse during their lifetime. Upon your spouse's death, the remaining assets in the trust could then be distributed to your children from your first marriage. If you were to leave your assets to your surviving spouse outright instead of a testamentary trust, on their death, your assets would go to their heirs and beneficiaries, which may not include your children from your first marriage.

A testamentary trust can also be useful if you are leaving assets to minors, a beneficiary with a disability, a spendthrift beneficiary, or where you have a significant estate and the beneficiaries are not willing or capable of managing your estate.

In certain circumstances, you may want to use a testamentary trust to hold your assets after your death instead of transferring them outright to your spouse or children.

Insurance

Although you may currently have some insurance coverage through RBC, it's important to determine if your current life and disability insurance coverage is adequate or whether you need to supplement it to meet your family's needs. A licensed insurance advisor can assess your insurance needs and analyze whether you have sufficient coverage.

You may have surplus assets that you know you'll never need in your lifetime, and you would like to leave them to your beneficiaries after your death. Any investment income earned during your lifetime on the surplus assets is taxable at your high marginal tax rate. If you have an insurance need, consider using the surplus assets to purchase a tax-exempt life insurance policy to minimize your current income tax and your taxes on death, as well as to maximize your estate left to your beneficiaries. You may be able to access the investment component during your lifetime either on a taxable basis or on a tax-free basis by borrowing using the cash surrender value as collateral for a loan. The loan is repaid after your death using the death benefit. Speak with a licensed life insurance representative to determine your insurance needs.

Debt planning

Interest is only deductible for tax purposes if the money you borrow is used for the purpose of earning income from a business or property. Income from property includes interest income, dividends, rents and royalties. If you have non-deductible debt, such as a mortgage or a line of credit, and you also hold an investment portfolio, you may want to consider a strategy to convert your non-deductible debt into tax-deductible debt. It may be possible to do so using a two-step process which involves selling your investments to pay off your personal debt and then borrowing to repurchase your investment portfolio. Since this strategy involves selling your non-registered investments, if your investment portfolio has accrued capital gains, you will trigger the capital gain. Be sure to speak with your qualified tax advisor to see if this strategy makes sense in your circumstances.

Using borrowed money to finance the purchase of securities involves greater risk than using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same, even if the value of the securities purchased declines.

U.S. tax and estate planning

If you travel or vacation in the U.S. and have a need for U.S. cash, consider opening an RBC U.S. dollar bank account through RBC Royal Bank in Canada or through RBC Bank USA in the U.S.

If you regularly travel to the U.S. for work, you may have a U.S. tax filing obligation even if you are not a U.S. person. If this is a concern, you should speak to Human Resources.

If you own a property in the U.S. and you're receiving rental income from the property, ensure you are filing an annual U.S. tax return (Form 1040NR) to report the income and expenses.

If you own U.S. assets, such as stocks of a U.S. corporation (including U.S. securities in a registered account) or U.S. real estate, you may be subject to U.S. estate tax on death, even if you're not a U.S. person. Speak to your qualified tax advisor about U.S. estate tax strategies to minimize or eliminate your exposure, if this applies to you.

Conclusion

This article briefly discusses some income tax and estate planning strategies that you may consider to reduce your family's overall tax bill and to maximize your estate. If you're interested in any of the strategies mentioned, your RBC advisor can provide you with additional articles that go into more detail about these strategies.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance 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, legal and/or insurance advisor before acting on any of the information in this article.

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