Wealth
Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Wealth planning strategies during a market downturn

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

In an economic climate that is constantly evolving and changing, this article presents key wealth planning strategies that you can consider to manage your financial well-being during this period of heightened volatility. There are many tax, estate and financial planning opportunities to explore and set you up for long-term success. In fact, certain wealth planning strategies can be even more effective during a market downturn. This article will discuss strategies to help you manage the tax you pay now and in the future as well as other wealth building strategies you may wish to consider during this unprecedented time.

Tax planning strategies

Take advantage of capital losses

Did you or your corporation report a capital gain on its tax return in any of the past three years? If so, now may be an opportune time to review your investment portfolio with your qualified tax advisor to determine if there may be a benefit in realizing a capital loss for tax purposes. A capital loss realized in the current tax year is first used to reduce any capital gains realized in the same year. If there are excess capital losses, they can be used to offset capital gains realized in any of the three previous tax years to generate a tax refund. As well, net capital losses realized in the current tax year can be carried forward indefinitely and used to offset future capital gains.

If you sell securities in a loss position and intend to repurchase the same securities, you should be aware of the superficial loss rules. The superficial loss rules may deny your immediate use of the loss where you or an affiliated person owns the identical security on the 30th day after the settlement date of the loss transaction. When possible, you may wish to consider some transactions that may enable you to sell your investment that's in a loss position and realize the capital loss while possibly avoiding the application of the superficial loss rules. For example, you could switch to another high quality similar security with similar exposure to the markets or transfer the security to anyone unaffiliated with you (e.g., a parent, adult child or sibling).

It may be possible to use the superficial loss rules to transfer your unrealized capital losses to your spouse. You may be interested in this strategy if you have unrealized capital losses that you can't use personally and your spouse has taxable capital gains that would otherwise be subject to tax (or vice versa). Even if you or your spouse can use the losses personally, you may still want to transfer capital losses to the spouse in the higher tax bracket, if that spouse has taxable capital gains. For more information on this strategy, ask your RBC advisor for the article on this topic.

Be careful when realizing losses in a corporation. A corporation has a capital dividend account (CDA), from which tax-free dividends can be paid out to the corporation's shareholders. The CDA is a notional account that keeps track of the non-taxable portion of capital gains and the non-allowable portion of capital losses realized by a corporation, among other amounts. The non-taxable portion of the capital gains realized in a corporation increases the CDA, while the non-allowable portion of capital losses immediately reduces the CDA. Since triggering a capital loss in a corporation will grind down the existing CDA balance, you may want to pay out a capital dividend from the CDA, if possible, before realizing losses in your corporation.

Maximize future income splitting with family members

If you have a spouse who earns less income than you or children with little to no income, you may want to consider implementing an income splitting strategy. Income splitting shifts income that would otherwise be taxed in your hands at a high marginal tax rate to your lower income spouse, children or other family members in order to take advantage of their lower marginal tax rates. Prescribed rate loans and gifting are two strategies to consider.

Prescribed rate loans

A prescribed rate loan strategy involves loaning to your spouse or common-law partner or to a family trust for the benefit of your children, grandchildren, nieces or nephews. By loaning your own personal funds to a family trust, the future investment income can be used to benefit your family members, for example to pay for private school tuition, camp fees, lessons or gifts. The investment income earned from the loaned funds in excess of the interest payable you must make annually on the loan can be taxed in the hands of your family members at a lower tax rate thereby increasing your family's after-tax investment income. Furthermore, by loaning the money, you can recall the loan if you need access to the loaned capital.

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Currently, the Canada Revenue Agency's (CRA) prescribed interest rate for loans is 2% but it is likely to drop to 1% for the quarter beginning July 1, 2020. The CRA prescribed rate of interest is calculated every quarter based on the average rate of 90-day treasury bills sold during the first month of the preceding quarter, rounded up to the nearest whole percentage point. If the interest rate drops and you already have an existing loan in place, you may be able to modify your existing loan. It is important to work with a qualified tax advisor to modify the loan to ensure that you can benefit from the lower prescribed rate. Simply changing the interest rate on your existing loan or setting out an arrangement to repay and immediately re-loan the funds will likely have adverse tax consequences.

Life-time gifting

As an income splitting measure, you may want to consider gifting funds to your spouse or common-law partner to contribute to their TFSA as any income or capital gains earned in the TFSA do not attribute back to you. You could also consider gifting funds to your adult child or family members, as any income and capital gains are not subject to attribution can be taxed in their hands. They could contribute these funds to their TFSA to benefit from tax free growth.

Plan for a possible increase to the capital gains inclusion rate

During the 2019 federal election campaign, the NDP proposed in its election platform to increase the capital gains inclusion rate to 75% from 50%. This has Canada speculating, again, if a hike to the capital gains inclusion rate may occur in the future. If a change is made, it is not known whether it would be effective immediately, be retroactive, or start at a future date. If you have a large unrealized capital gain consider triggering the capital gain for tax purposes. It is important to keep in mind it does result in a pre-payment of tax (albeit at a potentially lower tax rate) and loss of tax deferral. Furthermore, triggering capital gains tax may result in increased instalment payment reminders from the CRA in the future.

If you would like to plan for a potential increase in the inclusion rate, ask your RBC advisor for our article detailing some ideas to consider which include:

- Rebalancing your portfolio;
- Transfer appreciated securities to a holding company;
- Transfer appreciated securities to a spouse or common-law partner; and
- Donate securities in-kind to a registered charity.

If the value of your business shares has declined consider an estate freeze or refreeze

If your company is suffering from a depreciated business valuation, now may be an opportune time to consider an estate freeze, particularly if your company is expected to grow in value once the market conditions rebound. An estate freeze may help limit the value of the company that will be taxed in your hands upon death and also shift future growth to your successors or other family members. When considering an estate freeze, it is important to ensure that the current value is sufficient to sustain your financial needs as you are passing on the future growth to your family members. An estate freeze may also allow you to multiply the number of lifetime capital gains exemptions available on the future sale of your company, and, subject to the tax on split income (TOSI) rules, it may also allow for income splitting with family members.

If you have already implemented an estate freeze in the past, you still may be able to take advantage of a low business valuation by implementing a thaw and refreeze. You may want to consider this strategy if the current value of your business falls below your already frozen value.

Delay tax filings and payments where possible

The government has extended tax filing and payment deadlines for most taxpayers. Delaying your instalment payments or the payment of your taxes can help ease your immediate financial burden. However, while you may be tempted to take advantage of the extension, in some cases you may want to file as soon as possible, for example, if you expect to receive a tax refund, or if you are entitled to the Canada Child Benefit and/or the GST credit.

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Maximize tax credits and deductions available to you

It's important to be aware of the tax credits and deductions that may be claimed on your tax return to ensure maximum tax savings. Consider the following:

- If you are working from home on a regular basis (more than 50% of the time) during the COVID-19 pandemic, and if your employer provides you with a signed CRA Form T2200 "*Declaration of Conditions of Employment*" (Revenu Quebec Form TP-64.3), you may be able to claim a tax deduction for the portion of your home expenses that relate to your home office space if the expenses are not reimbursed by your employer. Bear in mind the period of coverage noted on the T2200 may only cover the weeks of the year you were required by your employer to work from home.
- Whether you have made a philanthropic commitment or simply wish to assist a registered charity during this time, consider donating securities in-kind, especially if you don't have the cash on hand at the moment. When you donate securities in-kind, you can benefit not only from an elimination of the capital gain accrued on the securities but also a donation tax credit based on the value of the securities. As such, it may cost you less to make a donation of securities than a donation of cash. If the securities you donate happen to be in a loss position, you can still benefit by claiming the capital loss as well as the donation tax credit. Before making a donation in-kind, it's important to contact the registered charity and verify that they can accept in-kind donations.

Estate planning

Ensure your Wills and Powers of Attorney are up to date

While you are reviewing your overall financial plan, it's important to ensure your estate plan is in order. Are your Wills and powers of attorney (POA) up to date? You may need to revise your estate plan to reflect the changes in your financial situation or to account for any strategies you've recently put in place. The following are some examples of when you should review your estate plan to ensure it is up to date:

- You or someone in your family has experienced a significant life event (e.g. marriage, separation, divorce, birth, death);
- You have a child or a grandchild that has been born in or moved to the United States or another country;
- You have a significant change in net worth;
- You have someone that is financially dependent on you;
- Your named executor(s) / liquidator(s) need to be updated; or
- You have made changes to your wealth plan that may need to be addressed.

If you haven't already done so, it is prudent to gather together your important legal documents (e.g., your Wills, POA, a title or deed to real estate, etc.) and keep them in a safe place. This will assist your executor (liquidator in Quebec) so that they can more easily access these documents as necessary.

The role of an executor is an extremely important one, involving several key legal obligations and "fiduciary duties," as well as significant managerial and administrative responsibilities. If you have questions about who to appoint as an executor or the typical responsibilities of an executor, please speak to an RBC advisor to find out more about the services provided by RBC Royal Trust.

Estate planning for business owners

While a corporation does not end when a shareholder passes away, there are a number of things you should consider when planning for the continued success of the corporation. Successful businesses succeed not because their owners are lucky to avoid disasters but because they were prepared for unplanned events. Review and/or update your shareholder/buy-sell agreements to ensure that these documents meet your and your corporation's current needs and financial situation. For example, if there is a provision in your buy-sell agreement regarding the valuation of the corporation, the stated method of valuating the company may not be appropriate in the current environment.

You may also want to review and/or update corporate documents such as by-laws to make sure the company has a proper plan for business continuity. For example, ensure that you have a plan in place in case an officer (e.g. signatory for banking) is unable to act due to sickness or disability.

A corporate-owned tax-exempt life insurance policy can provide income protection for survivors, fund buy-sell agreements or pay capital gains tax on death. Life insurance premiums are generally not tax-deductible, but it can be advantageous to purchase life insurance through a corporation rather than personally. The corporation's surplus assets can be invested in the insurance policy, grow on a tax-sheltered basis during your lifetime, provide a supplementary source of retirement income and be paid to your beneficiaries possibly on a tax-free basis. As part of your estate plan review, speak to your life-licensed representative about how a tax-exempt permanent life insurance policy may help you.

Financial planning strategies

Review your immediate cash flow needs

A written financial plan or retirement projection can help to put into perspective setbacks like the one we are seeing right now. Your RBC advisor can help discuss options available if your plan is off track. If you are concerned you may not meet your long-term objectives, consider any actions you can take in order to meet your goals. For example, can you continue working an additional few years? Can you reduce your retirement expenses? Can you save more now?

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During periods of market uncertainty, it is important to ensure that you can meet your immediate financial needs. If you are retired or will be retiring in the near future, withdrawing funds from your investment portfolio in a market downturn may significantly impact your nest egg as your portfolio might not recover sufficiently to provide a sustainable stream of income through retirement. If appropriate to your situation, consider the following strategies in the short-term to mitigate against this risk:

- Revisit your monthly budget to consider if reducing expenses is possible to avoid having to sell securities to subsidize cash flow in a down market.
- Reduce your registered retirement income fund (RRIF) minimum withdrawal by 25% if you don't currently need the cash flow for expenses. You are only required to withdraw 75% of your regular required minimum payment for 2020. Withdrawing the reduced minimum amount will provide you with flexibility of keeping more funds within your RRIF as well as delaying the tax on funds you don't need for your living expenses this year. In addition, consider transferring your RRIF payment in-kind to your non-registered account rather than selling an investment to make a withdrawal. This can be beneficial if you believe that the investments will increase in value as the market recovers.
- Consider using a home equity line of credit or a reverse mortgage as a means to supplement short-term cash flow needs during a down market in lieu of selling investments. Keep in mind both are a form of borrowing and do come with costs and potential risks.
- Where you are eligible for government benefits, consider applying for them early if you need the money and it makes sense in the context of your overall financial

plan. For example, if you are age 60 or older, consider applying for the Canada Pension Plan or the Quebec Pension Plan retirement benefits. If you are age 65 or older, consider applying for Old Age Security which is a monthly federal retirement benefit payable for life.

Educate your family members with financial literacy

Now may be a good time to introduce the wealth of benefits that an earlier approach to financial literacy can offer younger generations. You may want to ensure your family members have sound financial management skills whether wealth transfer is on the horizon or in the event of an unforeseen circumstance or life event.

Consider reaching out to your RBC advisor to access the Financial Literacy Program designed by RBC Wealth Management. This program offers a comprehensive and structured approach to building sound financial management skills.

Conclusion

During times like this, it is understandable to focus on the short-term market volatility. However, you can use these turbulent times to take advantage of some unique planning opportunities that focus on short and long-term wealth management. Consider the strategies in this article with your RBC advisor and qualified tax and legal advisors to help ensure that you are fulfilling not only your immediate financial needs but also your future goals and objectives.

During times like this, it is understandable to focus on the short-term market volatility. However, you can use these turbulent times to take advantage of some unique planning opportunities that focus on short and long-term wealth management.

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.