Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Retirement Compensation Arrangements (RCAs) for players of Canadian NHL teams who retire outside of Canada

Planning that may substantially reduce your overall tax rate

Although Canadian athletes may incur Canadian income taxes as high as 54%, proper tax planning for athletes who retire outside Canada (i.e. players from Finland, Russia, Sweden, US and even Canadians who leave Canada) playing on a Canadian National Hockey League (NHL) team may considerably reduce their overall tax rate. For example, an American hockey player may reduce his taxes by moving to Canada and playing for a Canadian team rather than a US team.

The top marginal Canadian income tax rate for a resident of a province with an NHL team ranges from a low of 47.7% for a resident of British Columbia to a high of 53.53% for a resident of Ontario. Although these rates initially appear quite high, establishing a retirement compensation arrangement ("RCA") for a foreign player or a Canadian player intending to retire outside of Canada may substantially reduce the overall tax rate.

This article outlines strategies, not all of which may apply to your particular 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 cross-border tax and/or legal advisor before acting on any of the information in this article.

An RCA may be established for an athlete to set aside part of the compensation package for retirement or loss of employment. The RCA provides significant tax benefits for players who become non-residents of Canada after leaving the Canadian NHL team, especially if the player becomes resident in a country that does not tax the RCA distributions or taxes them at a very low rate. If the RCA is structured correctly, withdrawals from the RCA as a non-resident of Canada may potentially be taxed at only 15-25%. A player should consult with a tax adviser of the country where he expects to be resident when he receives the distributions, to fully understand the tax implications in that resident location.

An RCA is generally defined as a plan or arrangement under which contributions are made by an employer to a custodian in connection with benefits that are to be received by an employee after any substantial change in services, the retirement or loss of office of the employee.

The RCA is established through the creation of a trust. Contributions to the RCA trust are not included in the player's taxable income in Canada. However, 50% must be remitted to a Refundable Tax Account (RTA) with the Canada Revenue Agency (CRA). This 50% refundable tax results in a prepayment of tax that is eventually refunded when distributions from the RCA trust are made. This results in only 50% of the remaining funds in the RCA trust actually being invested to earn income. The 50% refundable tax paid into the RTA does not earn income.

All distributions out of an RCA trust made to a beneficiary are fully taxable in Canada. If the player is a resident of Canada when he receives payments from an RCA trust, he will report the income as "other income" and the payments are taxable at his marginal tax rate. If the player is a non-resident of Canada when distributions are made, he will be subject to Canadian non-resident withholding tax on the payments received. The plan administrator will withhold 25% when making payments to a non-resident beneficiary. The withholding tax rate may be reduced if the beneficiary is a resident of a country that has a tax treaty with Canada and the payments meet the definition of pension payments pursuant to that treaty.

Although the incentive may be to put all of a player's compensation in excess of living expenses into an RCA, the contribution should not exceed a reasonable amount to fund retirement. Funding an RCA for a NHL player in excess of a reasonable amount may result in the contribution being considered an employee benefit plan. Distributions from an employee benefit plan are taxed at marginal income tax rates when distributed, even if the player is not a resident of Canada, thus; negating the benefit of the RCA contribution. Consequently, it is important to get an actuarial report certifying that contributions to the RCA are reasonable based on the player's salary, age, years of service and expected years in retirement.

> A NHL player on a US team is subject to US Social Security and Medicare taxes, while an American playing for a Canadian team is exempt from these taxes and only pays a lesser amount for Canada Pension Plan, Employment Insurance and provincial health premium taxes.

A US citizen who joins a Canadian NHL team may be able to reduce his overall tax rate to a rate that is lower than the rate he would incur playing for a US team if the team contributes to an RCA for his benefit. The tax consequences for an American are more complex than for players of another nationality, since US citizens are subject to US income tax even if they live in a foreign country, such as Canada. The US tax liability may be reduced by a foreign tax credit for taxes paid on income earned abroad.

This substantially reduces the US federal income tax liability. In the case of an American living and working in Canada, the US income tax liability may be reduced to zero. However, he may still obtain the following benefits if he moves to Canada:

Social Security and Medicare Taxes: A NHL player on a US team is subject to US Social Security and Medicare taxes, while an American playing for a Canadian team is exempt from these taxes and only pays a lesser amount for Canada Pension Plan, Québec Pension Plan, Employment Insurance and provincial health premium taxes. Therefore, if a player earns US$4 million a year, the US Social Security and Medicare Tax bill would be approximately US$99,500[1] compared to US$3,500[2] in CPP/QPP/EI and health care premium taxes for a NHL player on a Canadian team. The annual savings are approximately US$96,000.

State Income Taxes: A resident of a state is subject to the individual income taxes of that state on his total income, regardless of where he derives the income. State income taxes range from a high of 13.3% for residents of California to a low of 0% for residents of Florida or Texas. Even a resident of Florida or Texas will be subject to income tax in a state where he plays

1) [(US$118,500 x 6.2%) US social security] + [(US$4 million x 1.45%) + ((US$4 million - US$200,000) x 0.9%) Medicare], rounded to the nearest hundred
2) [C$3500 CPP/QPP/EI] + [C$1,000 estimated health premium tax] = C$4,500 @ .77, rounded to the nearest hundred

games. Similarly, a US citizen resident in Canada will only pay state income taxes on games played in a particular state, but these taxes will be fully creditable against his Canadian income tax liability. This credit eliminates the additional cost of state income taxes to residents of Canada. Therefore, an American in Canada may not incur any additional tax expense by playing in a state that taxes his income.

Although the tax liability without the RCA may be very high, the tax liability with the RCA is lower than if the player were resident in most states playing for a US team.

The savings of establishing an RCA are illustrated in the following two examples:

Example 1:

- Player has an annual salary of US$6 million
- Player is single with no other income or deductions

Example 2:

- Player has an annual salary of US$4 million and in addition the team contributes US$2 million each year to an RCA
- Player is single with no other income or deductions

The following table illustrates the tax cost to a player resident in a particular province for both examples. The table also illustrates the tax savings to the player with an RCA who receives distributions after retirement, when the player is a non-resident of Canada.[3]

3) All figures are in US dollars and were rounded to the nearest thousand. Assumes exchange rate of C$1=US$.77 for Canadian tax calculations.

Player resident of	Example 1: Tax liability for a player with an annual salary of US$6 million	Example 2: Tax liability for a player with an annual salary of US$4 million and US$2 million/year to a RCA paid after retirement to non-resident[1]	Annual RCA savings[2]
Alberta	US$2,855,000	US$2,395,000	US$460,000
British Columbia	US$2,840,000	US$2,386,000	US$454,000
Manitoba	US$3,004,000	US$2,496,000	US$508,000
Ontario	US$ 3,184,000	US$2,613,000	US$571,000
Quebec	US$ 3,178,000	US$2,612,000	US$566,000

1 All figures are in US dollars and were rounded to the nearest thousand. Assumes exchange rate of C$1=US$.77 for Canadian tax calculations.
2 Assumes Canadian 25% withholding tax rate on RCA distributions is paid and there is no tax liability arising in the country of residence when the RCA payment is received.

Although the tax liability without the RCA may be very high, the tax liability with the RCA is lower than if the player were resident in most states playing for a US team. The annual combined US federal, California, Social Security and Medicare tax liability for a player resident in California with compensation of US$6 million would be approximately US$2,947,000. This liability is significantly higher than if the player was a resident in any of the Canadian provinces as illustrated in example 2. Even if the player is a resident of Florida or Texas, the tax liability would be approximately US$2,620,000.[1] This liability is greater than that of all of the provinces with an NHL team.

A US citizen living in Canada and playing for a Canadian team may reduce his total tax liability to the amounts illustrated in Example 2, since the Canadian income tax may fully offset the US income tax liability by claiming a foreign tax credit. However, a US citizen playing for a Canadian team has to be careful not to have the team over-fund the RCA. The amount the team contributes to

1) This assumes a 2.35% state tax rate for games played in taxing states.

an RCA plus any earnings in the RCA for the benefit of a US citizen player will be considered taxable compensation to him, assuming there is no substantial risk of the RCA amount being forfeited.

Canadian taxes paid on annual compensation may be claimed as a foreign tax credit to offset the US tax liability arising from the annual compensation, the contribution to the RCA and the earnings in the RCA trust. In addition, some tax advisors feel there is a tax position whereby a US citizen player may be eligible to claim a foreign tax credit for an accrual of the 25% Canadian withholding tax that will ultimately be paid. However, careful planning with a cross border tax advisor is critical to ensure all Canadian taxes paid are fully creditable in the US. Nevertheless, the US citizen may be able reduce his overall tax liability by moving to Canada and playing for a Canadian team.

An NHL player who plans to retire outside Canada has many opportunities with Canadian teams. Proper tax planning may optimize the financial opportunities.