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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Financial planning and tax planning for a professional athlete who plays for a Canadian or U.S.-based sports team

Preserving your wealth and financial security

For professional athletes, implementing financial planning and tax planning early in your career is essential to preserving and maximizing your wealth and financial security.

This article is intended for professional athletes who play for a Canadian or U.S.-based sports team. It discusses common financial planning and tax planning strategies that you, the professional athlete, your family and/or agents may consider implementing throughout your professional career.

Common financial planning and tax planning strategies

As a professional athlete, you face a variety of unique financial planning and tax planning considerations. This is primarily because you have the potential to earn a significant amount of money starting at a young age and in a short period of time. When your professional career as an athlete ends (which, for some, may occur as early as their late 20s or 30s) the level of your earnings potential may subside and you may be at a much younger age than the average person when entering retirement. This may mean you'll have many years where you might need to draw from your savings accumulated during your professional career to support the lifestyle you've become accustomed to. For this reason, it's important to make sure you've put aside a sufficient amount of earnings from those high but short earning years from which you can draw.

The following is a checklist (not an exhaustive list) of common financial planning and tax planning strategies to consider, which are discussed in this article:

- Tax residency
- Signing bonus
- Retirement Compensation Arrangement (RCA)
- Endorsement income
- Charitable giving
- Will and power of attorney (POA)
- Life and disability insurance
- Family income splitting
- U.S. gift, estate and generation-skipping transfer tax (GSTT)
- Probate
- Real estate ownership and deductibility of mortgage interest
- Family law
- Asset preservation
- Retirement, investment and financial planning
- Borrowing and credit
- Qualified advisors

Tax residency

Your residency for income tax purposes can have a significant impact on the overall taxes you will pay on your income (including signing bonuses, regular salary and other potential income) and what's available for you to save or spend.

When you play for a U.S. or Canadian professional sports team, generally you'll remain or become a resident for income tax purposes of the U.S. state or Canadian province or territory in which your team is based. However, it's also possible with proper planning to be considered a tax resident of a different U.S. state or Canadian province or territory than where your team is based. This may occur if you have certain residential ties (referred to as primary ties) to a different location that are greater than your residential ties to the location where your team is based. Primary ties include where your home and family are located. It may also occur, for example, if you spend a certain number of days in a particular state.

In Canada and the U.S., there are differences in tax rates from one U.S. state or Canadian province or territory to another. Therefore, if you're able to establish residency for tax purposes in a location that has a lower tax rate, you may reduce your overall taxes payable on your income.

If you play for a Canadian or U.S.-based sports team and your primary residence is in a country outside of North America, you could potentially remain a resident of that foreign country if you maintain substantial primary ties there, and there's an income tax treaty between Canada or the U.S. and your country of residence that includes "tie-breaker rules," which deem you to be a resident of only one country. Sometimes this may result in significant tax savings.

When you play for a U.S. or Canadian professional sports team, generally you'll remain or become a resident for income tax purposes of the U.S. state or Canadian province or territory in which your team is based.

In some cases, you may be subject to income tax in more than one country. For example, if you're a U.S. citizen or green-card holder who establishes tax residency in Canada, you're subject to tax on your worldwide income in both the U.S. and Canada. This is because liability for U.S. income taxes is based both on citizenship and residency. As a result, you're generally required to continue to file a U.S. income tax return and report your worldwide income, Furthermore, in the U.S., many U.S. states impose what's referred to as a "jock tax," which is essentially a tax on a professional athlete who earns income in the state, even though they may not be a resident of that state for income tax purposes.

Having to pay taxes in more than one country generally does not always create double tax due to the possibility to claim foreign tax credits or exclude certain income earned in one country from tax in another.

Your tax residency status is generally based on your particular facts and circumstances. If you establish significant ties to the U.S. state or Canadian province or territory where your home team is located, it may not be possible to choose the location where you'll be resident for tax purposes. However, where it's possible to do so, you may be able to reduce your taxes payable on your income. In this regard, a qualified professional tax advisor can prepare a comparative analysis to determine which U.S. state or Canadian province or territory (or other foreign country) is preferential from a tax residency standpoint. Where it's shown that it's more beneficial to be a tax resident of one location as compared to another, you will need to consider whether it makes sense for you to make the necessary lifestyle changes in order for you to remain or become a resident of that particular location. This may involve purchasing a home, moving to or having your spouse/children remain in a specific location, or spending a significant number of days in a specific location.

Signing bonus

You may enter into various contracts with professional sports teams throughout your athletic career. In many cases, a signing bonus is included as part of your contract.

When you receive a signing bonus, it will be subject to tax in the country where you're resident for tax purposes. If the signing bonus is paid by a professional sports team based in a country you're not a resident of, that country may also have the right to impose tax on the signing bonus. For example, under the Canada-U.S. tax treaty, a signing bonus may be subject to a maximum tax rate of 15% in the country (Canada or the U.S.) where the team is based if you're a tax resident of the other country when it's received.

There may be tax planning strategies that can be employed to minimize taxes payable on a signing bonus if you're a Canadian or U.S. tax resident playing for a Canadian or U.S.-based sports team. This is the topic of a separate article, a copy of which can be obtained from your RBC advisor.

RCA

If you're currently a resident of Canada for tax purposes, but you intend to become a non-resident of Canada in the future (e.g. when your professional career ends and you plan to return to your original country of tax residency), implementing an RCA strategy could reduce the overall tax rate you pay on your earnings. This strategy may be beneficial, for example, for a U.S. citizen playing on a Canadian-based sports team who will retire in the U.S.

An RCA may be established for an athlete to set aside part of their compensation package for retirement or loss of employment. Contributions to an RCA are not included in your (the athlete's) taxable income and subject to higher Canadian tax rates that might apply to you during your Canadian residency. Although 50% of the contribution must be remitted to a refundable tax account, this tax will be refunded when distributions are made from the RCA. When you make withdrawals from the RCA as a non-resident of Canada, the distribution will be subject to a Canadian non-resident withholding tax of 25%, or potentially a lower tax rate pursuant to a tax treaty between Canada and your country of residence. If you reside in a country that does not tax the RCA withdrawal or taxes it at a very low rate, this may provide a significant tax benefit and result in a lower overall tax rate on these earnings.

The use of an RCA by professional athletes is the topic of a separate article. For more information, please ask your RBC advisor for a copy of that article.

Endorsement income

If you're a Canadian tax resident, setting up a Canadian corporation to receive endorsement income or other marketing revenue could be beneficial from a tax perspective. This is because the income may be subject to lower tax rates in the corporation than if earned personally, providing for a tax deferral benefit until these earnings are withdrawn from your corporation. If you're a U.S. citizen or green-card holder living in Canada, there are additional considerations in terms of using this structure due to potentially punitive U.S. tax rules that may apply to U.S. shareholders of foreign corporations. Also, similar planning for a U.S. resident with a U.S. corporation may not provide the same tax benefits from a U.S. tax perspective.

If you're currently a resident of Canada for tax purposes, but you intend to become a non-resident of Canada in the future (e.g. when your professional career ends and you plan to return to your original country of tax residency), implementing an RCA strategy could reduce the overall tax rate you pay on your earnings.

If you're a U.S. citizen or resident, speak to a qualified tax advisor about the advantages and disadvantages of setting up a corporation to earn this type of income.

Charitable giving

There are various options for fulfilling your charitable giving intentions. Some professional athletes set up private foundations to make charitable donations and others donate to public foundations. Charitable donations may also reduce your Canadian and U.S. income taxes. However, it's important to understand how the tax benefit of the donations may change where donations are made to charitable organizations resident in a country that is different than your country of tax residence.

If you're interested in creating a lasting legacy in your own name, a donor-advised fund may be an easy option to consider to achieve your philanthropic goals. Please ask your RBC advisor for information about this option and speak to a qualified cross-border tax advisor to determine if it makes sense for you.

Will and POA

It's a good idea for you to have a valid Will and POA in the jurisdiction where you're resident. If you own real estate or other property in another jurisdiction (e.g. you're a Canadian resident who owns a vacation property located in the U.S. or vice versa), you may wish to consider having a separate Will and POA drafted in accordance with the laws of the jurisdiction in which the property is located. This will help ensure the property can be properly managed and administered in the event of your incapacity or death. It is possible that a Will or POA drafted in your jurisdiction of residence may not be accepted as valid in the foreign jurisdiction where your property is located.

Life and disability insurance

Nobody likes to think about death or disability; however, it's important, especially for professional athletes and their families, to consider if life and disability insurance coverage makes sense.

Some forms of insurance provide for tax-free investment growth on the premiums paid into the policy. You may consider using surplus cash accumulated in an otherwise taxable investment account to purchase these types of policies. This may provide benefits from an investment and tax point of view.

Since you could potentially play for a Canadian or U.S. team and may become a resident of Canada and/or the U.S. at different stages throughout your professional career, it's important to consider both the Canadian and U.S. tax treatment of certain insurance policies when determining the type of policy to use.

It may be difficult to obtain certain types of insurance due to the nature of your career; however, there are some insurance companies that specialize in providing protection to professional athletes.

Family income splitting

If you're a tax resident of Canada and have a spouse or children with no or low income, there are several income splitting strategies you can implement to lower your family's overall Canadian tax burden. The objective of these strategies is to shift income that would otherwise be taxed in your hands at a high marginal tax rate to your lower-income family member in order to take advantage of their lower tax rates. This results in the family's overall tax burden being less than it would be if the income had just been earned by you and taxed in your hands at your high marginal tax rate.

Examples of common family income splitting strategies that may be effective for Canadian residents include a spousal loan and a loan to a family trust. Both of these strategies are topics of separate articles, copies of which can be obtained from your RBC advisor.

These strategies are generally not relevant for those who live in the U.S.; however, if you're a U.S. person who lives in Canada, are planning to move to Canada or will eventually return to Canada, these strategies may be considered in certain circumstances. You should speak to a qualified cross-border tax advisor regarding the relevance of these strategies in light of your circumstances.

U.S. gift tax, estate tax and GSTT

In addition to U.S. income tax, the U.S. tax system includes a U.S. transfer tax, which is composed of a U.S. gift, estate

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and GSTT. Both Canadian residents and U.S. persons may be subject to U.S. transfer taxes and the tax liabilities may be significant.

U.S. gift tax may apply on property gifted during your lifetime. U.S. estate tax may apply on property you own when you pass away. GSTT may apply on property transferred to a certain classification of individuals referred to as "skip individuals," which includes for example, your grandchildren.

It's important to understand your exposure to U.S. transfer taxes and be aware there are various strategies that may be implemented to reduce your exposure to these taxes. These taxes should be taken into consideration when doing any estate planning. If you're a Canadian resident or U.S. person living in Canada, please ask your RBC advisor for various articles related to this topic.

Probate

When someone passes away owning property (e.g. a bank account, investment account, real estate property, vehicles, etc.) in sole name, your executor may be required to obtain probate in order to transfer the ownership or title of the property. Probate is an administrative procedure to validate a Will and confirm the authority of the executor named in the Will to act on behalf of the estate. Many jurisdictions charge a tax or fee when a Will is probated and the tax/fee varies by jurisdiction. If you hold assets in more than one jurisdiction, and your executor is required to probate your Will in those different jurisdictions, you could potentially pay probate fees twice on the same estate assets.

The probate process may be lengthy and costly. There may be strategies you can use to help minimize the risk of probate, such as holding assets as joint tenants with right of survivorship, designating beneficiaries on registered accounts and life insurance policies, or transferring assets to living trusts.

In the U.S., for example, the use of a revocable living trust to hold U.S. real estate is a common estate planning strategy to minimize U.S. state probate tax. Each strategy has its advantages and disadvantages and should be carefully considered in light of your other tax and estate planning goals. It's also important to note that strategies used in one jurisdiction may not work in another. For this reason, it's important to work with a qualified cross-border tax and legal advisor to determine what strategy might be appropriate, taking into consideration your estate planning objectives, the location of your assets as well as any potential changes in residency status.

Real estate ownership and deductibility of mortgage interest

If you own or plan to purchase a personal home, vacation property or an investment property in Canada or the U.S., it's important to be aware of the Canadian and U.S. income tax treatment with respect to owning, renting or disposing of the particular property. The tax treatment in each jurisdiction may also depend on your tax residency or citizenship status. As an example, there are special tax benefits for Canadian tax residents who own a home or vacation property. If your home or vacation property qualifies as your principal residence, the capital gain triggered when it's disposed of (e.g. sold or gifted) may be fully or partially sheltered from Canadian income tax. For U.S. income tax purposes, similar benefits apply when a principal residence is sold; however, there are differences in the criteria that has to be met in order for the property to qualify as your principal residence. As well, there are limits on the amount of the capital gain that may be excluded from U.S. tax.

In addition, for U.S. tax purposes, if you have a mortgage on a principal residence or second home, you may be able to deduct the mortgage interest, subject to certain thresholds. This deduction is not available for Canadian tax purposes. The mortgage interest may only be tax-deductible for Canadian tax purposes if the property is used to earn income.

There are also estate planning considerations. Depending on your circumstances, your RBC advisor may be able to provide you with a separate article that includes a more detailed discussion regarding owning a home or vacation property in Canada or the U.S.

Family law

The implications and risks of a marriage or relationship breakdown is often a difficult subject to address. Planning for the potential of a marriage or relationship breakdown may be further complicated by the fact that you and your spouse or common-law partner may be living in different jurisdictions at the time of separation. This can impact how family law issues with respect to division of property, support and divorce are resolved. If you're interested in trying to protect the wealth you may have accumulated during your professional career from division on marriage or relationship breakdown, you should speak to a qualified legal professional about any steps you can take to protect these assets, which may include signing a marriage contract or co-habitation agreement. It's very important to consult with legal professionals who specialize in family law matters in the jurisdiction(s) you and your spouse or common-law partner currently live in or may live in in the future.

In addition, for U.S. tax purposes, if you have a mortgage on a principal residence or second home, you may be able to deduct the mortgage interest, subject to certain thresholds.

Asset preservation

As a high-income earner and high net worth individual who is in the public eye, there is a greater risk that you might be subject to frivolous lawsuits by those looking to gain from your wealth. You may wish to consider strategies to protect your assets from a lawsuit or other creditors. One common way to do this is to limit the amount of property you own directly. You may decide to transfer ownership of certain property into a family member's name. Alternatively, you may transfer property to a domestic or foreign trust, thereby changing the legal owner of the property, and potentially placing the property out of reach of creditors who may have a legal claim. It's important to note that a transfer to a family member or trust could be set aside if it's found to be made with the intent to hinder or defeat a creditor's claims. As well, it's important to consider that these strategies could result in a loss of control and ownership of the assets.

There may also be certain types of retirement plans and individual investments that also provide creditor protection.

Before any of these strategies can be considered, a review of the tax and legal issues (including cross-border issues) needs to be considered with qualified professional tax and legal advisors.

Retirement, investment and financial planning

Both Canada and the U.S. offer a number of tax-advantaged retirement and savings plans. Contributions made to a retirement plan can be made with pre-tax or after-tax earnings and generally allow for a tax deferral until distributions from the retirement plan are received. A number of saving plans allow you to contribute after-tax earnings that can grow tax-free in the plan and may be withdrawn in the future without further taxation.

It's important to understand the tax implications of investing in certain retirement or savings plans where the plan is offered in one country and you are or will become a resident of another country.

While both retirement and savings plans are important for a professional athlete, they're generally not sufficient as a means to save since the annual contribution limits permitted in these types of plans are quite low as compared to your annual earnings. Therefore, the bulk of your savings will come from investments made outside of these tax-sheltered plans. Having a tax-efficient investment strategy in a prudently managed non-registered investment portfolio is very important.

To ensure you're on track to have sufficient savings to support your lifestyle during retirement, your RBC advisor may suggest preparing a financial plan. This plan will help you determine if you have an appropriate savings and a spending strategy in place or whether changes are needed. A financial plan is not centered on investment planning; it also considers having the financial means to fulfill all of your financial and personal life goals and needs.

Borrowing and credit

The use of borrowing (leverage) can be a very important tool for managing and enhancing your wealth and cash flow needs. It may be used alongside tax planning strategies you may implement throughout your professional career. A mortgage to purchase a home or the use of borrowed funds for investment purposes are some examples of how leverage can be used.

For Canadian tax purposes, where borrowed funds are used to purchase investments (i.e. stocks, bonds, mutual funds, etc.) that pay or have the reasonable potential to earn investment income, including interest and dividends, the interest paid on the loan proceeds may be tax-deductible. For U.S. tax purposes, interest paid on loans for investment purposes are generally tax-deductible up to the net investment income earned. It's important to speak to a qualified tax advisor about the tax rules that apply in your country of tax residency.

It's essential to constantly manage your credit and monitor your borrowing needs and implement strategies for paying off your loans as appropriate. Speak to your RBC advisor for more information about this topic.

Qualified advisors

There are a number of complex cross-border issues discussed in this article that apply to a professional athlete. Therefore, it's important to work with a team of qualified professionals, including cross-border tax and legal advisors, together with a trusted financial advisor,

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who will work together to ensure you receive the right planning. If you require a referral to a qualified cross-border tax or legal advisor, please ask your RBC advisor for assistance.

Summary

At various stages in your professional career, there will be a need for a careful review of relevant financial and tax planning. Advance planning is particularly important before the signing of your first professional contract and before you accept any contract to transfer to a different professional sports team. To ensure your financial security is maintained well into the future and you maximize your wealth, financial and tax planning should begin as soon as possible.

Your RBC advisor can work with you and your qualified tax and legal advisors to ensure your receive the right planning that is tailored to your individual circumstances.

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.