Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Receiving a significant cash inflow

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

This article will provide information if you have recently received a substantial sum of money; either through an inheritance, lottery, gift, or other means. Understanding the available options will help you make the best decisions for the future with this sudden change in your financial situation.

Given the sudden change in your financial situation, a number of different thoughts and emotions may race through your head such as the emotional high that comes with a lottery win or the emotional low that comes from the loss of a loved one. You may wonder: What should I do first with this money? Do I have enough to retire immediately? How do I put this money to best use? Can I finally buy something I always wanted? What would my loved one have wanted me to do with the money?

Having worked hard to pay your bills and save whatever you can for your retirement and other financial goals, you may be feeling somewhat overwhelmed about what to do with this sudden new wealth. This article outlines some common financial planning issues to reflect on, as well as suggestions on how to use your new wealth to your best financial advantage, for now and the future. By considering some financial planning ideas now, you may be able to make your new wealth go further and provide an even greater benefit.

Initial issues to consider

The time required to adjust to this change in fortune can vary (six months to one year is not uncommon) depending on the amount of money received, your personality and the circumstances surrounding this event.

For example, if the money came from the death of your spouse or parent, you may need time to work through the grief and adjust to your new circumstances. If you just won the lottery and have little money management experience, you may be feeling paralyzed as you try to decide what to do to first.

If you received an inheritance and have the added responsibility of being an executor for the estate of the deceased person, you may be feeling even more overwhelmed, particularly if there are several other beneficiaries or if you are unfamiliar with the duties of an executor. If this is your situation, ask your advisor about the benefits of appointing a professional corporate executor to carry out these responsibilities on your behalf. This service is available through your RBC advisor.

The emotions you are feeling as a result of your new-found wealth may influence you to make a decision that you would not otherwise make. It may therefore be a good idea to delay making decisions about what to do with the money until you feel you have adjusted to your new situation. In the meantime, consider putting the money in an investment such as a Treasury bill or redeemable guaranteed investment certificate (GIC) that will guarantee the capital but still keep the investment liquid. This will give you time to seek the advice best suited to your unique situation.

You may also wish to set aside a small amount (so you do not feel guilty about spending it) as “fun money” to do something you enjoy; however, try to avoid making impulsive decisions.

With new-found wealth, you should also be careful with your money as you may be subject to requests and solicitations from family, friends and charities. Remember, it is okay to say no or not yet to requests that you receive. That will give you more time to put a plan in place.

Make a wish list

While you adjust to your new financial situation, take some time to consider all the possible uses for your new wealth. For example, you could use the funds to pay down existing debts, purchase a new vehicle, take a vacation, help your children purchase a home or start a business, or save for your children’s or grandchildren’s education. Deciding how to use these funds will take some consideration.

It is not uncommon for the recipient of a large amount of money to have some charitable intent. If this is one of your goals, ask your advisor how RBC can help you create a lasting legacy to benefit the charitable organizations of your choice for many years to come, as an alternative to a one-time cash donation.

As your first step, put together a current picture of your financial situation. This does not need to be difficult. By making a list of your current financial needs (such as your outstanding debts), you will be well on your way to making smart financial decisions to ensure the best use of your new wealth. You can complete this list on a single sheet of paper.

Prioritize items on your wish list

The next step is to prioritize the various items you have included on your list. If you have outstanding debts with high interest rates, you may wish to give the reduction of these debts priority over other items. Your advisor may be able to help you with this step and can also provide independent advice at a time when you may be dealing with deep emotional issues. Your advisor can also help you sort out the various investment “deals” and solicitations that you may be presented with as a result of your new-found wealth.

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Your advisor can work with you to determine the impact that the reduction in debt could have on your future cash flow. You could apply a portion of your new funds toward reducing a store credit card debt that has an annual interest rate of more than 20%. This decision could save you significant amounts in interest costs per year, which you could use toward some of the financial needs you outlined in step one. By paying down the store credit card debt first, you could save enough to be able to allocate money to other needs. Planning your financial decisions allows you to make your money work harder for you.

Develop a personalized long-term financial plan

Consider developing a solid, personalized, long-term financial plan with the help of your advisor. This will give you better insight into whether your long-term objectives (e.g., the ability to sustain a desired lifestyle) can be achieved. Once you know that your long-term goals can be achieved, you can then focus on short-term objectives such as upgrading your existing home or helping out a family member. You should also consider reviewing your Will and power of attorney with a qualified estate planning legal advisor in the light of your new-found wealth to see if any changes are appropriate.

Don’t forget the tax issues

The thought of paying income taxes can be the downside of new- found wealth. In addition to paying the government money that you would probably like to use for other purposes, the complex tax rules can be confusing. However, it is important to consider income tax issues whenever you engage in any financial planning. You want to maximize the amount of cash you have left after your taxes are paid to use toward the needs and desires you identified on your wish list.

Some good news about lottery winnings and inheritances is that they are generally received on a tax-free basis, but there are exceptions. In some cases, the lottery winner can choose to receive an upfront lump sum payment on a tax-free basis or an annuity payment for life, a portion of which may be subject to tax. Your advisor can help you determine which of these options (a life annuity or a lump sum payment) is best for you.

You may want to consider investing your new-found wealth to generate regular cash flow. You will have to pay taxes on any income you make, but remember that earning certain types of income, such as Canadian dividends and capital gains, may result in less tax payable than putting the money into interest-bearing investments. The amount of tax that you pay on each dollar of income is an important consideration because it affects the after-tax amount that you have available to meet your needs.

Your needs may include putting some of the money aside to fund your children's post-secondary education. A lifetime contribution of $50,000 is available for each beneficiary, if you contribute to an RESP. These funds could grow tax-sheltered until they are withdrawn at a future date. In addition, the Canadian government provides a 20% matching contribution (called the Canada Education Savings Grant) on the first $2,500 contributed to an RESP each year for a child who is 15 years old or under (there are special rules for beneficiaries who are 16 or 17). If you make a contribution of more than $2,500 in a year, you may be able to receive a grant of up to 20% of the first $5,000 if there are prior years when you did not make RESP contributions for your child or receive a grant payment. Tax is payable on the income earned in the RESP only when the growth in the plan is withdrawn to fund the child's post-secondary education. This income is taxable on the child's tax return, which is likely to be at a low marginal rate.

An alternative to saving for a child's future post-secondary education in an RESP is to save for the child in a regular non-registered investment account. This option may have tax advantages because capital gains and Canadian dividends receive preferential tax treatment, as described above, while withdrawals from RESPs are taxed in the same way as interest. However, the interest and dividend income will be attributed to you and taxed at your marginal tax rate.

Your advisor can help you decide which of these alternatives is better for you based on your specific circumstances.

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Conclusion

You have many choices for using your new-found wealth. By stepping back and analyzing your circumstances using basic financial planning techniques, it is possible to ensure that the funds you receive provide the most benefit to you and your loved ones. Some complex financial planning issues may arise, so please consult your advisor and your qualified tax advisor if you would like assistance with these issues.

The following are some ways you can use your new-found wealth, depending on the amount of money you received:

- Invest the funds to meet your future financial needs and provide current cash flow from regular interest or dividend income
- Pay down existing debts for which interest is not tax-deductible such as credit card balances or home mortgages
- Pay for renovations to your existing home
- Purchase a new home or investment property
- Put money away for a child or grandchild for their post-secondary education
- Gift amounts to family members who require some financial assistance
- Help a child purchase a home or start a business
- Donate a portion to a charity