RCF News

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Estate Planning and your RCA

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Estate Planning is an ongoing process, and adjustments must be made from time to time or when significant life changes arise. Luckily, the planning relative to the Retirement Compensation Arrangement (RCA) can be adjusted as circumstances change to meet your clients' estate-planning needs.

Whether it's a sale of a business, pre-nuptial or divorce issues, family equalization issues, a golden handcuff of a key employee or better creditor proofing, the RCA is a vital component of estate planning an advisor must consider for his or her high-earning business-owner, key-employee and executive clients.

The following case studies help shed some light on how an RCA can resolve such issues and achieve overall financial and estate planning goals.

These case studies are based on actual client situations over the last 23 years that RCF has been providing its unique turnkey RCA program. Some changes have been made to protect client identities.

Case #1: Family Equalization

As parents, you want to keep an even hand with all of your children. You don't want them to fight over your estate after you have passed away. Your daughter works in the family business, but your son does not. You and your daughter both have RCAs sponsored by your company since she is senior level manager, and she will be your successor in the company. On the other hand, your son is not in the family business, and he has no interest in working for your company. A simple change in the beneficiary designation to make your son the contingent beneficiary of your RCA Trust upon the death of the surviving spouse could solve the equalization problem.

This simple designation change ensures your son is looked after, and keeps an even hand with your daughter. And if you have some concerns with your son responsibly using the funds in the RCA, you can instruct your RCA Committee Members on when or how distributions are to be made to him. It also can work for adult children that may have some other disabilities that could make them vulnerable to misuse of the funds.

Often times, the parent (Plan Member) and the Spouse do not need or take their full entitlement from the RCA so that children and/or the grandchildren become the beneficiaries on the death of the Plan Member. If all of the assets in the trust are not distributed to your children, your grandchildren can become the beneficiaries of the trust. Since the RCA Trust is not subject to the 21 year rule, your children or grandchildren do not have to deal with the deemed disposition of assets every 21 years.

Case #2: Creditor Protection

You are a successful Business Owner but as with any business, there are potential environmental, accidental, or negligence liabilities. A new competitor could also suddenly have you losing your competitive edge, and eventually your market share. Preparing for the unthinkable is part of planning that we must consider. We have all seen good companies experience bad luck over the years.

You know that corporate owned Investments including Life Insurance are vulnerable to creditors. If you are a Professional such as a Doctor or Lawyer with a Professional Corporation, you cannot setup a Holding

Company to hold the shares of the corporation, and you know that your E&O protects you personally but not the Corporation. And if your business did have a Holding Company, you know that some investments held in it could still be vulnerable to creditors such as lenders by way of shareholder actions.

Your RCA can complement other retained earning strategies; thus spreading the risk around and not keeping all your eggs in one basket. The RCA is an intervivos Trust that does not form part of your estate, and is separate from corporate or personal assets. Since it does not form part of your estate, certain information including beneficiaries can remain private unlike your estate which becomes public domain upon your passing.

Case #3: Estate Freeze

You have worked with your specialists in developing an estate freeze for your corporation. You have managed to save some taxes in the short run, but your business has taken off a lot more than you expected. As a result, you froze your estate at a low value compared to what your company is worth today. Unfreezing your Estate Freeze is complicated, and can open up some other problems. In any event, it's clear that the Estate Freeze is now starting to work against you and the corporation.

Your RCA can complement your existing Estate Freeze strategy. Assuming you have the unfunded pension liability, the excess earnings in the corporation can be directed into the RCA Trust. As a result, you have addressed this rather complicated problem with a very simple solution through the use of your RCA Trust.

Case #4: Business Succession

You run a family business, and your children are your preferred choice to take over the business. Your children can run the company but cannot afford to buy the business (or at least at market price from Parent/Seller).

Your RCA has been established to provide you, the Parent (Seller), a supplemental retirement income, which can also be funded on a post-retirement basis. As a result, your children (the Buyer) can proceed with the buyout of your business by funding your RCA with the pre-tax operating income from the company, which is far more efficient than having them borrowing funds from the bank on an after-tax basis to fund your buyout. You as the Seller / RCA Plan Member are not taxed until distribution from RCA begins allowing for long term tax deferral.

Alternatively, this arrangement can be used in conjunction with a cash purchase of your shares. Let's say you have not used up your $750,000 Lifetime Capital Gains Exemption (LCGE) Limit, then the Buyer can secure the cash or loan up to your LCGE, and the rest can be funded through the RCA. The shares of the company are in escrow until the funding has been completed, so you retain control in the event your children cannot meet their funding obligation.

Case #5: Golden Handcuffs

You are getting close to retirement, and are ready to start drawing from your RCA. You would like your Son to take over the business. However, he is not quite ready yet, and if you hand the business to him now, he could run the company to the ground. But, you know that with a little more guidance and maturity, he would do just fine. Just then you have a flash back to when you first taught him how to drive a car, and how frustrating and frightening it was. So you are contemplating on just winding the company down to avoid that experience all over again.

Your long-time friend and employee helped you build the company since inception. She owns no shares, and she wants to slow down as well. She could certainly help guide your Son as he learns the business. She is well paid, but why should she stay? If she retires too soon, it will complicate your plans. You want to be fair; you need to keep the shares of the company for the family; but you still need to provide with her an incentive to stay. Paying a larger salary or bonus does not provide a real incentive for one to stay.

Under guidelines established by CRA, the executive should have pension of 2% times years of service up to 70% times final average earnings. The RCA is wrapped around executive's corporate RRSP/MPPP to provide a supplemental pension to CRA guidelines. A vesting clause gives incentive for the Executive to stay until normal retirement ensuring your son has enough experience to run business. The contributions are 100% deductible to the corporation and not taxable in the executives hand until distribution begins from the plan post-retirement. Now your succession planning can continue as is without having to make substantial changes to your estate planning.

Case #6: Charitable Giving

You have a well-balanced retirement plan consisting of your Non-Registered investments, a small amount of RRSPs, an IPP, and an RCA. You are in the middle of negotiating the sale of your business, so you will also make use of the capital gains exemption limit. You have more than enough to live off of, along with your spouse and children. You are interested in leaving a legacy behind for a charity that you strongly believe in. Part of your RCA Investment Account (RCAIA) includes a life insurance policy that maintains the tax-exempt status of the RCA Investment Account which has been over funded over the years. The premiums paid for the insurance policy within the RCA have also been 100% tax-deductible to the corporation

You adjust your Plan Document and beneficiary designation in the RCA Trust so that when the life insurance proceeds are paid tax-free into the RCA Trust upon your death, the Trust will then pay the proceeds to the registered charity of your choice, which also receives the tax-free proceeds. Certainly it's a win-win-win strategy for you, your company, and the charity.

Case #7: Structured Investments

You are an outgoing owner of a car dealership getting very close to retirement, and you are looking to diversify your RCA Investments. Financing is arranged through a lender so the RCA Trust borrows money to purchase the dealership's showroom and the service building. The new owner of the dealership pays rent to the RCA Trust, which eventually pays off the loan balance, and providing a regular flow of income into the RCA Trust. This ensures the RCA is continuously funded to ensure that you and your spouse are looked after.

Case #8: Pre-nuptials

You are a Business Owner or Key Employee managing a very profitable business. You are divorced but have been dating someone for a few years now, and you are soon to be considered to be common law under the province you reside in. Things between you and your significant other are going well, but your adult children and your estate lawyers are deeply concerned over your estate in the event you pass away. How can you make your adult children happy, satisfy your lawyers, and still look after your new love?

The solution can be as simple as a changed beneficiary designation in the RCA. After your significant other consults with their own independent legal counsel, they sign off your entire estate in the event of your passing if they become the sole beneficiary of your RCA given their now common-law status. Your children are assured that family assets including the family cottage everyone grew up in stays in the family, and your new partner is financially looked after you have passed away.

Case #9: RRSP Loss Recovery

Many RRSP or DC/MPPP investors have taken a big hit on their investments over the last two years. Under current legislation, you are not allowed to make extra contributions into the plan to recover the losses. However, those losses can be made up by having the Company make contributions into a RCA allowing for pension loss recovery not available in RRSPs and other DC/MPPP Plans.

In addition, as a business owner, you can establish a Group RCA to supplement Group RRSPs or MPPP losses for employees. What a great way to attract and retain key employees!

Conclusion

Your RCA is one of the few CRA approved long term tax deferral strategies to address your pension shortfall and discrimination due to the legislative funding caps and limits on your RRSP or other Registered Pension Plans such as IPPs, and MPPPs.

With that said, it is so much more in that, it can provide benefits from today long before you actually start taking income from the plan. It is a critical component to any estate plan for a high earning Business Owner/Manager or Key Employee, and should be integrated with your financial and estate plans.

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About the Author

Pierre Ghorbanian is the Managing Partner of RCF. Case consulting with Plan Members, Sponsors, Plan Advisors and Accountants are his primary responsibilities. He is a contributor to RCF's RCF***News*** publication, and other industry publications. He is also is a regular seminar presenter to Plan Sponsors, Members, and Plan Advisors on financial and estate planning strategies through the use of RCAs.

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