RCAs – Still Relevant in 2016?

A unique aspect of RCAs is the refundable tax concept where one-half of all contributions and investment income earned by the RCA Trust is remitted into a Refundable Tax Account (RTA) administered by CRA. The RTA does not earn any investment income. Any investment income earned by the RCA Trust loses its investment character (i.e., for example, dividends and capital gains lose their preferential character). The RCA receives refunds from the RTA when benefits are paid. $1 is refunded from the RTA for each $2 paid in benefits from the RCA Trust. Clearly, the purpose of the RTA is to limit the tax-deferral effectiveness of an RCA and make the entire structure effectively tax-neutral.

Given this backdrop, should advisors still consider RCAs for their clients in 2016? Due to shifting trends in:

- the globalization of the workforce,
- rising tax rates,
- aging demographics,

an advisor may find that RCAs can achieve one or more client objectives and thus RCAs can be considered in a variety of client situations.

More Favorable Features of RCAs

Here are some key features that make RCAs attractive:

- the primary purpose of an RCA is to make contributions to a custodian on behalf of an employee with the intent of distributing assets to the employee (beneficiary) due to retirement, loss of office or employment,or any substantial change of services provided by the employee. Contributions are deductible to the employer in the year they are made. Benefits are taxable to the beneficiary when they are received.
- Contributions can be made by the employee and are deductible so long as such contributions are required under the terms of the RCA and are less than or equal to the contributions made by the employer.
- Very large employer deductible contributions can be actuarially substantiated based on earnings and salary history .
- RCAs are generally established as a trust and thus offer creditor protection on corporate assets.
- RCA is a non-registered pension plan and offer greater flexibility in
- terms of statutory requirements for annual contributions, benefit terms such as vesting, retirement age and payout options, and greater flexibility for eligible investments.
- For individuals that are resident of a different country but earn income in Canada are quite often subject to an Income Tax Treaty. An Income Tax Treaty between Canada and another country takes precedence over each country's respective domestic tax legislation. RCA distributions to recipients are typically subject to 25%. For example, the Canada-US income tax treaty can reduce the rate to 15% if the distribution from the RCA is structured as a series of periodic payments over at least a ten-year period. Further, there is no additional tax payable by the non-resident, which is typical.
- Survivor benefits payable from the RCA passes outside the estate of the RCA recipient, free of probate fees.
- Contributions to an RCA are exempt from provincial health premiums. For example, for Ontario employers, the premium savings can be as high as 1.95% of the RCA contribution amount.

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Specific Client Situations
The following are specific instances and scenarios in which RCAs are well suited.

Accumulating a Creditor Proof Retirement Asset
The primary purpose of an RCA is to accumulate a retirement and creditor proof asset for amounts in excess of statutory registered pension plan accruals.

- Target client - business owners who have to accumulate large asset amounts in a short period of time to secure retirement income. Ideal client has annual T4 earnings significantly in excess of $150,000.
- Target client – business executives belonging to supplemental pension programs where benefit security is more important than tax efficiency. (Provide pension benefits above statuatory limits)
- Target client – business owners of higher risk ventures where creditor proofing of corporate assets is a desired objective.
- Target client – key and highly compensated employees of private firms where flexible benefit design can be used to encourage employee retention.

Tax Efficiency
Although RCAs are designed to be tax-neutral, the globalization of the work force in conjunction with tax treaties can provide tax efficient compensation.

- Target client – professional athletes. The National Hockey League Association is aware and accepting of RCAs for foreign athletes playing in Canada with the intention of returning to their home country. For example, a properly implemented RCA can reduce the tax rate to 15% of RCA disbursements for an American athlete returning back to America.
- Target client – foreign business executives. With the increased globalization of the workforce, increasing numbers of foreign executives are asked to provide their expertise on corporate Canadian operations. An RCA should be a key consideration to provide foreign executives with tax efficient compensation in an analogous manner compared to professional athletes described above.
- Target client – successful business owners that reside in provincial jurisdictions that have personal marginal tax rates above 50% (for example: Ontario, Quebec). Business owners often "bonus down" to the small business deduction limit will realize true tax deferral on the tax rates above 50%. Even if personal tax rates are lower than 50% (for example: Alberta, BC), the up-front tax-cost may be offset by other factors and tax savings offered by the RCA.

Further tax efficiencies can be realized by the selection of investments. For example, income does not have to be reported until it is realized. Less frequent reported income will result in a greater long term rate of return due to the compounding of unrealized income. Additional examples include investment in life insurance policies and annuity contracts (including split-dollar arrangements) where the investment component of the policy is not subject to refundable tax.

AdditionalScenarios
In addition to the above, there are other circumstances where an RCA may be warranted.

- Target client – severance payments for executive. A large severance payment can be paid into an RCA to ensure benefit security and realize potential tax efficiencies by paying out benefits over a longer period of time.
- Target client – business owners selling their businesses. An RCA can be used in creative ways to facilitate the sale of a business. For example, due to the tax deductibility of contributions to an RCA, the purchaser is eliminating a layer of tax in the source of funds used to purchase the business. Another example, an RCA can be used by the purchaser to guarantee and induce the prior owner to a period of service after the sale (for example, use a vesting schedule).

Summary
In summary, RCAs continue to be useful vehicles in a variety of situations for a broad range of clients. However, RCAs are complex and require careful implementation to ensure that the objectives of the clients and their advisors will be realized. Please call me with any questions you may have.

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