



TAX, RETIREMENT
& ESTATE PLANNING
SERVICES



WEALTH TRANSFER STRATEGY 8

RRSPs and RRIFs on death – frequently asked questions

Most Canadians are familiar with the tax advantages of using registered savings plans to save for their retirement years. Contributions to Registered Retirement Savings Plans (RRSPs) are deductible and any growth or income earned on the underlying investment in the RRSP or Registered Retirement Income Fund (RRIF) is not taxed until withdrawn.

What may be less clear is what happens on the death of an RRSP or RRIF owner. Frequently asked questions have been addressed in order to provide more clarity in an area that may not be entirely understood.

WHY AM I RECEIVING A T4RSP OR T4RIF¹?

Under the Canadian income tax laws, an individual is deemed to have disposed of his or her assets, including RRSPs and RRIFs, for their fair market values at the time of death. The T4RSP or T4RIF sent to your legal representative or executor² will indicate the fair market value of your RRSP or RRIF at the date of your death.

It is the responsibility of your estate, and ultimately your estate beneficiaries³, to pay the income taxes on the RRSP or RRIF disposition at death, as there are generally no taxes withheld on amounts paid directly to a beneficiary named on the registered savings plan. This is something to take into consideration when developing your estate plan and determining how to distribute your assets at death.

WHAT ARE THE INCOME TAX IMPLICATIONS?

The value of your RRSP or RRIF, as indicated on the T4RSP or T4RIF slip, must be included in your income for the year of death. This amount is fully taxable as regular income. However, as discussed later, there are ways to achieve a tax-free rollover on this taxable income from your RRSP or RRIF upon death.

WHAT ABOUT INCOME EARNED AFTER THE DATE OF DEATH?

An RRSP or RRIF remains tax-sheltered throughout the year of death and the following calendar year. An additional tax slip will be issued to report any increase in the value of the RRSP or RRIF from the date of death to the date of payout. This increase in value is taxable to the named beneficiary(ies) or to the estate, although a tax-free rollover on this increase in value is available just as it is for the plan value on the date of death, if certain criteria are met.

The potential for a tax-free rollover on income earned in an RRSP or RRIF after the date of death only applies to income realized up to December 31 of the year after the year of death. For example, if an individual died on June 1, 2012, the registered plan would remain tax sheltered up to December 31, 2013. If the registered plan remains in place beyond this date, the income earned after December 31, 2013 becomes taxable in the hands of the beneficiary or the estate.

One exception to this rule is when an RRSP or RRIF is provided by an insurance company. The income earned after December 31, 2013 from a life insurance company RRSP or RRIF will have the potential for a tax-free rollover no matter when the death proceeds are paid.

It is also possible to have any post-death decreases in the value of the RRSP or RRIF carried back and deducted against the year of death RRSP or RRIF income inclusion.

¹ Québec residents receive another form, RL2, used to file their tax returns with Revenu Québec. ² In Québec an executor is referred to as a liquidator. ³ In Québec an estate beneficiary(ies) or a beneficiary(ies) named under a will is referred to as an heir(s). As well, the reference to a beneficiary(ies) of a contract is also referred to as a beneficiary(ies).



HOW CAN THE INCOME TAX BILL ON DEATH BE REDUCED?

It is possible to minimize the RRSP or RRIF income inclusion on death and on income earned in the RRSP or RRIF up to December 31 after the year of death if the deceased's RRSP or RRIF is left to a "qualifying beneficiary." The beneficiary of the RRSP or RRIF can be named directly on the plan document, or in the deceased's will. Sometimes, the deceased's will may state that a particular person is the beneficiary of a certain amount of the estate, which includes the deceased's RRSP or RRIF (if there's no named beneficiary(ies) on the RRSP or RRIF, or if the beneficiary(ies) is predeceased).⁴

If the beneficiary is a qualifying beneficiary, it is possible to instead have the value of the RRSP or RRIF taxable to the beneficiary. This same tax treatment results whether a qualifying beneficiary is named directly on the plan documents, or named beneficiary via the will. If you are not sure if this applies to you, please talk to your legal or tax advisor.

WHO IS A QUALIFYING BENEFICIARY?

A qualifying beneficiary includes a:

- Spouse or common-law partner⁵
- Financially dependent infirm child or grandchild
- Financially dependent child or grandchild

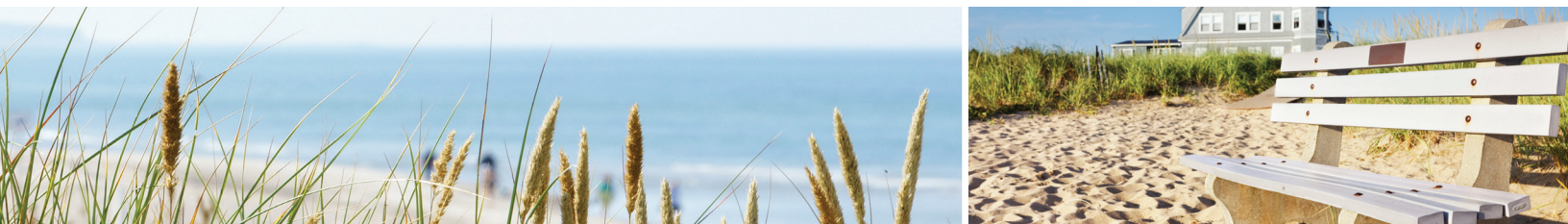
SPOUSE OR COMMON-LAW PARTNER

If the beneficiary of the RRSP or RRIF is a spouse or common-law partner, it is possible to transfer the assets directly to that person's RRSP or RRIF as a tax-free rollover. If the surviving spouse or partner is under age 71, the RRSP or RRIF can be transferred to that survivor's RRSP, otherwise the assets will be transferred to the survivor's RRIF or eligible annuity. The RRSP or RRIF issuer must be informed that the transfer is to take place before December 31 of the year after the year of death. Further, the actual transfer (or purchase) of the RRSP or RRIF (to the survivor's RRSP or RRIF) must be completed in the year the survivor receives the deceased's RRSP or RRIF, or within 60 days after the end of the year.

If this is done, the surviving spouse or common-law partner will report the value of the deceased's RRSP or RRIF on his or her tax return for the year (this value will be reported on a T4RSP or T4RIF slip). The surviving spouse or common-law partner will then receive an offsetting deduction for the qualifying transfer under paragraph 60(l) of the *Income Tax Act* (Canada) to his or her own RRSP or RRIF.

When a qualifying transfer of the RRSP or RRIF has taken place, the spouse or common-law partner will be taxed on any withdrawals made in the future. If the transfer does not take place in due time (that is, in the year the plan assets are received or within 60 days after the end of that year) the full value of the RRSP or RRIF will be included on the surviving spouse or partner's tax return. No offsetting tax deduction will be allowed.

⁴ In Québec, it is only possible to designate a beneficiary on a payout or deferred annuity RRSP or a RRIF issued by an insurance company. ⁵ For Québec residents, because civil union spouses are not recognized from a federal income tax point of view, they will be recognized under the definition of a common-law partner in Québec if they satisfy certain criteria.



In the case of a RRIF, a successor annuitant may have been named in the plan or the will. This means that the existing RRIF continues on and the surviving spouse or common-law partner simply receives the same periodic payments as the deceased had received from the RRIF. No special taxation issues arise on death when a successor annuitant is named; instead the successor is taxed on any payments made to him or her each year from the RRIF.

INFIRM, FINANCIALLY DEPENDENT CHILD OR GRANDCHILD

If an RRSP or RRIF is left to a child or grandchild who was financially dependent on the deceased taxpayer by reason of mental or physical infirmity, the RRSP or RRIF is not taxed in the hands of the deceased. In this situation, the infirm child or grandchild can transfer the assets into his or her own RRSP or RRIF. The transfer must take place in the year the RRSP or RRIF is received, or within the first 60 days of the next year. If this is done, the dependent infirm child or grandchild will only be taxed on any withdrawals made in the future.

An infirm child or grandchild is considered to be financially dependent on the deceased if his or her income in the previous year was less than the basic personal amount plus the disability amount for that previous year. If their income is above this amount they may still qualify as financially dependent, but only if the financial dependency can be demonstrated based upon the particular facts of the situation.

The infirm child or grandchild may also choose to purchase an eligible annuity with the RRSP or RRIF, and annuity payments will also be taxed to the child or grandchild.⁶

MINORS, FINANCIALLY DEPENDENT CHILD OR GRANDCHILD

If an RRSP or RRIF is left to a minor child or grandchild who was financially dependent on the deceased, the value of the RRSP or RRIF is taxed to the child or grandchild and not to the deceased. Where the minor child or grandchild uses the RRSP or RRIF funds to purchase a term certain annuity (maximum term to age 18), only the annuity payments will be taxed in that minor's hands as they are received.

As with transfers to other qualifying beneficiaries, the transfer must take place in the year the RRSP or RRIF proceeds are received, or within the first 60 days of the following year. Depending on the age of the minor child or grandchild, this may only defer tax for a short time period. However, since the minor usually has little or no other income, this may provide the opportunity to have the income taxed at a lower tax rate than it would have been on the deceased's final tax return.

A minor is considered to be financially dependent if the minor's income for the previous taxation year was less than the basic personal amount for that previous year.

ADULT CHILD OR GRANDCHILD

If an RRSP or RRIF is left to an adult child or grandchild who is financially dependent, it is possible to include the fair market value of the RRSP or RRIF in the child or grandchild's income instead of the deceased's income. However, the adult child or grandchild will not be able to purchase an eligible term certain annuity as this option is only available to a minor child or grandchild up to age 18. Although there is no available product to reinvest the RRSP or RRIF to receive a tax deferred rollover, there is a strong likelihood the adult child or grandchild will pay less tax on the RRSP's or RRIF's fair market value income inclusion versus the deceased due to having a lower marginal tax rate.

If an RRSP or RRIF is left to an adult child or grandchild who is not financially dependent or mentally or physically infirm, there is no tax deferral available by naming the adult child or grandchild as beneficiary. The RRSP or RRIF will be fully taxable on the final tax return of the deceased and the RRSP or RRIF will be paid to the adult child or grandchild named as beneficiary. An adult child or grandchild is considered to be financially dependant if his/her income for the previous taxation year was less than the basic personal amount for that year.

⁶ An RRSP or RRIF can also be transferred to a financially dependent infirm child or grandchild's Registered Disability Savings Plan (RDSP) on a tax deferred basis.

WHAT HAPPENS IF THE ESTATE OF THE DECEASED WAS NAMED BENEFICIARY?

If the estate is named as beneficiary of the RRSP or RRIF, generally the fair market value of the RRSP or RRIF is included in income on the deceased's final tax return. However, where an amount is paid from an RRSP or RRIF to the estate and a person who is a qualifying beneficiary is named as beneficiary of the estate in the will, the legal representative of the estate, along with the beneficiary may file a joint election to treat the RRSP or RRIF proceeds as being paid directly to that qualifying beneficiary.

If this joint election is filed with the Canada Revenue Agency (CRA), the deceased and the qualifying beneficiary(ies) will receive the same tax treatment as if the qualifying beneficiary(ies) had been named directly on the RRSP or RRIF. In other words, the tax bill on death can be rolled over tax-free if that qualifying beneficiary transfers assets into an RRSP, RRIF, eligible annuity or term certain annuity to a maximum age of 18, where applicable. The qualifying beneficiary must be a beneficiary of the estate for an amount at least equal to the value of the RRSP or RRIF for this rollover to occur.

In order to benefit from the RRSP rollover provisions, it is necessary to fill out Form T2019⁷ (Death of an RRSP Annuitant – Refund of Premiums) and have it signed by both the legal representative of the deceased, and the qualifying beneficiary. For a RRIF, Form T1090⁸ (Death of a RRIF Annuitant – Designated Benefit) should be completed. These forms can be found on the CRA website at www.cra-arc.gc.ca

Caution: Unless there is a specific reason for having assets flow through your estate, such as to make use of tax losses or deductions or to apply any special instructions contained in the will, it may be a better idea to name a beneficiary, other than your estate, directly on the RRSP or RRIF. Having assets flow through your estate may subject them to claims by your estate creditors and/or probate and other estate administration fees.

WHERE CAN I GET MORE INFORMATION ON THE TAX RULES ON DEATH?

The CRA's website contains information on the tax rules on death, including the specific rules that apply to RRSPs, RRIFs and their beneficiaries. As the tax rules on death can be complicated, you may also wish to consult your tax or legal advisor for advice tailored to your specific situation.

⁷ The Québec equivalent to the T2019 is the TP930. ⁸ The Québec equivalent to the T1090 is the TP961.8.

IDEAL CANDIDATES

Individuals with an RRSP or RRIF:

- Who want to understand the income tax implications on death
- Who want to minimize or reduce their income tax bill on death
- Who could use more information on the differences between the naming of certain beneficiaries

TAKE ACTION

If this applies to you, then:

- Contact your advisor
- Ensure your beneficiary designations and will produce the intended tax consequences on death for your RRSPs and/or RRIFs
- Review your estate plan, including your RRSPs and/or RRIFs with a tax or legal advisor

FOR MORE INFORMATION, PLEASE CONTACT YOUR ADVISOR OR VISIT MANULIFE.CA/INVESTMENTS



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