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RRSPS CAN BE TAXED AT DEATH -BUT THEY DON'T HAVE TO BE

Submitted by: Sun Life Financial (to read this article online, CLICK HERE)

Registered retirement savings plans (RRSPs) continue to be a major part of Canadians' assets. In 2015, the average contribution amount rose from $3,737 to $4,117 for the 53% of Canadians that contributed to an RRSP[1]. But what happens to clients' RRSPs when they die? They may not know about a major tax hit that can occur at death. Canadian law deems them to have cashed in their entire RRSP or Registered Retirement Income Fund (RRIF) when they die. In fact, when someone passes away, all or a large part of their registered plans could be taxed at the maximum marginal rate.

With this in mind, how can you help reduce the tax impact on your client's estate and keep their legacy intact?

GOOD PLANNING IS KEY

A little planning can go a long way. You can shift all or a portion of the tax burden on a deceased person's registered plans to someone who can defer tax or who will pay tax at a lower rate. If there's a qualified beneficiary[2] and certain conditions are met, it's possible to keep the entire amount from being included in the deceased's income. And qualified beneficiaries acquiring an RRSP or RRIF under these circumstances can also apply tax-deferral strategies on registered money received due to a death.

Let's look at four options for transferring an RRSP at death. Then we'll review the options for RRIFs.

OPTION 1: USE THE BENEFICIARY DESIGNATION TO DIRECTLY TRANSFER RRSPS

You can prevent an RRSP from being included in the deceased's income when all or part of the funds qualify as a 'refund of premiums.' To transfer an RRSP directly to the surviving spouse or common-law partner[3], the Canada Revenue Agency (CRA) requires three conditions to be met:

- The spouse must be the **sole** beneficiary designated within the RRSP account, or in the will.
- The spouse must transfer the RRSP directly into another RRSP, RRIF or annuity in their name.
- The transfer must occur within 60 days of the end of the year that the spouse is deemed to have received the refund of premiums. In cases where the distribution of the refund of premiums is delayed beyond December 31 of the year following death, the spouse must pay tax on any growth in the refund of premiums after that date. The spouse beneficiary will receive tax slips in their name indicating 'refund of premiums,' but will be able to deduct the amount transferred to their own RRSP or RRIF.

The result is that the registered money moves tax free to the surviving spouse's RRSP, RRIF or annuity, and isn't treated as income for the deceased.

OPTION 2: RRSP BENEFIT RECEIVED BY THE ESTATE

In all other cases, the RRSP benefit is deemed to be received by the estate. The amount of tax depends on the joint decisions made by the beneficiary or heir and the estate trustee.

What happens if the spouse is an heir of the estate or if a qualified beneficiary doesn't meet one of the required conditions for making a direct transfer? In this case, the estate trustee and the spouse can designate the payment as a refund of premiums and jointly sign CRA form T2019. The spouse is then deemed to have received the amount directly, versus through the estate.

This decision will reduce tax payable by the deceased. The recipient spouse must include the refund of premiums as income on their own tax return in the year received. To avoid being taxed on these amounts, the spouse must contribute the money they receive to an RRSP, RRIF or annuity, and then deduct that amount from their income.

Although more complicated than Option 1, the result is the same: the registered money moves tax free to the surviving spouse's RRSP, RRIF or annuity, and isn't treated as income for the deceased.

OPTION 3: TRANSFER TO A FINANCIALLY DEPENDENT MINOR CHILD OR GRANDCHILD

A person with a financially dependent child or grandchild ('child') under age 18 immediately before their death can transfer an RRSP to that child, even if there's a surviving spouse. Similar conditions as those listed in Option 1 apply to the deceased's taxes:

- The child must be the sole beneficiary of the RRSP, as designated in the RRSP or in the will.
- Through their legal representative, the child must instruct the RRSP issuer to transfer the RRSP directly into a term certain to age 18 annuity in the child's name. The estate trustee and the child's legal representative must complete CRA's form T2019 with the required adjustments, if applicable. The transfer of a refund of premiums from the deceased to the child eliminates the tax on that money for the deceased.
- The transfer must occur within 60 days of the end of the year that the child is deemed to receive the refund of premiums. The child will receive tax slips in their name indicating 'refund of premiums.' The child will need to include the refund of premiums in income, but the transfer of that money to the annuity generates an offsetting deduction, resulting in no immediate tax to the child. Only the annuity payments a child receives during the tax year are treated as income, providing a measure of tax deferral.

OPTION 4: TRANSFER TO A FINANCIALLY DEPENDENT ADULT CHILD WITH A PHYSICAL OR MENTAL CONDITION

If a client dies while an adult child or grandchild is financially dependent on them because of a physical or mental condition, it's possible to reduce the deceased's tax bill by transferring the proceeds of a registered plan to that dependent. The transferred amount is deducted from the deceased's income and included in the dependent's income. If the dependent transfers the money into their own RRSP, RRIF or eligible annuity, they can then deduct the transferred amount from their income.

An eligible annuity is a fixed or life annuity with or without a guarantee period, where the dependent is the annuitant. The term for the guarantee period can be any number of years not exceeding 90, minus the annuitant's age when the annuity is issued.

A dependent who doesn't have a physical or mental condition but was financially dependent on the deceased may also receive a refund of premiums. However, there's no way for the dependent to defer taxes: they'll be taxed on the total value of the RRSP. This is generally a worthwhile strategy as the financially dependent child won't necessarily have much income, so their tax rate may be lower than the deceased's.

Tax Tip: Where provincially permitted, remind clients to designate their spouse as the successor holder in their RRSP, RRIF and TFSA account, to avoid including their assets subject to probate, and to avoid having to change their will.

AND WHAT ABOUT RRIFS?

Similar to RRSPs, a person is deemed to have received an amount equal to the fair market value of their RRIF immediately before their death. If the deceased's spouse isn't the successor annuitant, or if the dependent children or grandchildren are the heirs, the rules described for RRSPs also apply to RRIFs, with some minor differences. For example, instead of qualifying as a 'refund of premiums,' money from a RRIF is referred to as the 'designated benefit.'

Unlike RRSPs, a spouse can be a successor annuitant of a RRIF. When the RRIF owner dies, the successor annuitant assumes ownership of the deceased's RRIF and payments continue to them without interruption. However, if the spouse was named as a beneficiary, the same process used for RRSPs would apply. If the couple intends for the RRIF income to continue to the survivor, naming that spouse as a successor annuitant provides a cleaner transfer than naming the surviving spouse as beneficiary.

INVESTMENT VALUE FLUCTUATIONS IN AN RRSP OR RRIF

Sometimes, weeks or even months go by between the time of death and the distribution of property. During that time, the value of investments in the deceased's RRSP or RRIF is likely to fluctuate. If the value decreases, the loss may be deducted on the deceased's tax return. If the value increases, the difference will be taxable income for the estate or beneficiary of the RRSP or RRIF.

YOUR STRATEGIC ADVANTAGE

When a client dies, the tax implications related to RRSPs and RRIFs can be challenging. You could become the go-to person for family members who have financial questions. The more you know about tax measures that are favourable to heirs, the better you can support them. Just remember that one size doesn't fit all — clients have different realities and financial needs — and estate planning isn't just about minimizing taxes. It facilitates the transfer of a person's wealth the way they want, to the people they want.

ESTATE PLANNING RESOURCES

Sun Life's estate planning tools include an Estate maximization whiteboard video, which presents a strategy using life insurance to help maximize an estate. Share it with clients — they might be surprised at the options available and the control they could have.

To learn more about transferring registered savings plans at death and estate planning solutions, talk with your Sun Life Sales Director .

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[1]2016 BMO Annual Post-RRSP Deadline Study:http://newsroom.bmo.com/manual-releases/BMO-Annual-Post-RRSP-Deadline-Study–Contribution-
[2]A qualified beneficiary is the deceased's spouse or common-law partner, financially dependent child or grandchild under the age of 18, or financially dependent child or grandchild with a mental or physical illness.
[3]Throughout this article, spouse includes common-law partner.

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