



TD Wealth

Taxation on the Death of an RRSP Plan Holder

The fair market value (FMV) of a Registered Retirement Savings Plan (RRSP) is generally included as income in the year a person dies. As the RRSP may be one of your largest assets, this can potentially give rise to a very large income inclusion on your terminal tax return, attracting a significant tax liability.

This article explores alternatives available to minimize the tax liability and to maximize the amount left to the intended beneficiaries of the RRSP. Note: the same transfer options that exist for an RRSP upon the death of a plan holder also apply to a Registered Retirement Income Fund (RRIF).

Beneficiary Designations

When you die, your assets will pass to your beneficiaries through your estate as directed by your Will (or by provincial succession legislation if you do not have a valid Will). However, specific assets can be passed directly to your beneficiary(ies) without first passing through your estate (this does not apply in the province of Quebec). Your RRSP is one such asset. An RRSP can be transferred directly by way of a beneficiary designation clause in your plan application form. This allows the assets in your RRSP to bypass your estate and be paid directly to the named beneficiary.

The main advantage of utilizing the beneficiary designation is that probate fees are avoided (in provinces where the fee applies) on the transfer of your RRSP assets.

If there is no beneficiary designated in the plan, the Will governs to whom the RRSP assets pass. There may be a specific clause giving the RRSP assets to a certain beneficiary(ies). In the absence of such a clause, the RRSP falls into the residue of your estate

and is distributed in accordance with your instructions as to how the residue of your estate should be distributed.

Whether your RRSP assets are transferred by way of beneficiary designation or through your Will, the FMV of all your RRSP assets at the date of your death is deemed to have been received just prior to death and is therefore included in your income in the year of death. The resulting tax liability depends mainly on who receives the RRSP assets.

Who's getting your RRSP?

1. A Surviving Spouse or Common-Law Partner

If the designated beneficiary of your RRSP is your surviving spouse or common-law partner (hereinafter collectively referred to as the “Spouse”), then the RRSP funds received by the surviving Spouse qualifies as a “refund of premium”, which is eligible for special tax treatment.

The value of the RRSP can be taxed in the hands of the surviving Spouse. Alternatively, the surviving Spouse may transfer the refund of premium to an RRSP or RRIF in his or her own name, or purchase an annuity for his or her own benefit, thereby continuing the tax deferral.

If the surviving Spouse is not named as the designated beneficiary of the plan (and no one else is named), the RRSP assets will fall into your estate. However, in certain situations, the surviving Spouse may jointly elect in conjunction with the executor of the estate to preserve the tax deferral treatment as if the beneficiary designation had been made.

In order for the executor and surviving Spouse to be able to make this joint election, the surviving Spouse's beneficial interest in the estate must be sufficiently large that payments can be reasonably allocated to him or her. This will be the case where the surviving Spouse's share of the estate is large enough to allow him or her to receive the RRSP proceeds. Conversely, the joint election may not be made if:

- there is a specific gift of the RRSP proceeds to some other person;
- the surviving Spouse is allocated only specific assets other than the RRSP proceeds; or
- the total gift to the surviving Spouse is less than the RRSP proceeds



2. A Financially Dependent Child or Grandchild

If the designated beneficiary of your RRSP is a financially dependent child or grandchild, again the amount received by the beneficiary qualifies as a “refund of premium” eligible for special treatment.

In this case, to reduce the amount included in the beneficiary's income, the funds can be used to purchase a term certain annuity with a term not exceeding the beneficiary's 18th year where the beneficiary is a financially dependent minor child or grandchild.

If the financially dependent child or grandchild is mentally or physically infirm, there are additional options: the funds can be transferred to the beneficiary's own RRSP or RRIF on a tax deferred basis (similar to the transfer to a surviving Spouse's RRSP or RRIF described above).

Alternatively, a financially dependent child or grandchild who is dependent because of a physical or mental infirmity may rollover RRSP proceeds, on a tax-deferred basis, to a Registered Disability Savings Plan (RDSP).

The amount that can be rolled over is limited to the beneficiary's available RDSP contribution room. The lifetime contribution limit is \$200,000. The transferred amount:

- will not attract the Canada Disability Savings Grant (CDSG); and
- will form part of the taxable portion of the disability assistance payments (i.e., will be included in the beneficiary's income when withdrawn from the RDSP).

When the financially dependent child or grandchild is not named as a designated beneficiary, the same opportunity to utilize a joint election (as described above in the case of a surviving Spouse) is also available.



3. A Charity

If someone other than your surviving Spouse or qualifying dependent child or grandchild is the beneficiary of your RRSP, then your RRSP must be collapsed and the balance paid to the designated beneficiary or your estate. The value of the RRSP will be included in your income on your terminal tax return.

However, there is a tax advantage if you make a registered charity the beneficiary of your RRSP assets upon your death. If you name a charity as a beneficiary, you are entitled to a charitable donation tax credit equivalent to the amount donated. This will effectively offset the tax owing on the plan at the time of your death.

4. Other Beneficiaries

When none of the above mentioned options apply, your death will create an income inclusion of the RRSP amount in your tax return in the year of death and hence a tax liability.

If you specifically gift the RRSP to a particular person who is not your surviving Spouse or qualifying dependent child or grandchild, the estate is responsible for the resulting tax liability. The plan beneficiary has joint liability for the tax only if the

estate is bankrupt. This means that if there are insufficient funds left in the estate, the Canada Revenue Agency will look to the recipient of the RRSP to pay the tax.

You will need to carefully determine how to gift the proceeds of the RRSP. Where you leave your RRSP to a specific recipient and the rest of your estate to other beneficiaries, the end result may be that the RRSP beneficiary receives all the RRSP funds, while the estate is left with the responsibility of paying all the taxes associated with the income inclusion. This may leave less in the estate than you intended for your other beneficiaries. A possible solution for dealing with the taxes pertaining to your RRSP on your death is to purchase life insurance to pay your estate taxes to ensure that all your beneficiaries will receive the full intended benefit. We encourage you to speak with your tax and legal advisor and TD Wealth advisor to determine which option best fulfills your objectives.



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