Waterhouse
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Tax Treatment of RIFs upon Death

Our tax rules require all Registered Retirement Savings Plans (RSPs) be de-registered by the end of the calendar year in which the annuitant turns 71. There are three options available to the annuitant when the maximum age limit is reached:

1. *Withdraw and pay tax on the entire RSP balance;*
2. *Use the RSP balance to purchase an annuity; or*
3. *Transfer the RSP balance to a Registered Retirement Income Fund (RIF) on a tax-deferred basis.*

The RIF tends to be the most popular choice for maturing RSP balances because there are no immediate tax implications; the rollover from RSP to RIF is simple to complete, and the rolled-over amount can continue to grow on a tax-sheltered basis.

But what happens to the RIF when the annuitant dies?

General Rule

When a RIF annuitant dies, the annuitant is considered to have received the entire fair market value of the RIF immediately before death and that amount must be included in their income in the year of death. The estate of the RIF plan holder will be responsible for paying the income tax; the beneficiary of the RIF will only be taxed on any increase in value after the date of death of the RIF plan holder.

Exceptions

The general rule does not apply if:

1. **A spouse or common-law partner is named as successor annuitant.** (In this article, the terms spouse or common-law partner will be referred to as the "Partner".)

If the RIF plan holder has named their Partner as a successor annuitant, either in the RIF contract or in their Will, the surviving Partner becomes the new annuitant of the RIF, and the RIF payment will continue to be made to them. All amounts paid after the date of death will be taxed to the surviving Partner.

2. **There is a joint election by the estate and surviving Partner to treat the latter as successor annuitant**

Even if the RIF plan holder has not named their Partner as a successor annuitant, the executor may allocate the RIF to the surviving Partner, in satisfaction of an entitlement under the Will of the RIF plan holder, by giving written instructions to the financial institution to treat the surviving Partner as successor annuitant.

3. **A Partner is designated as sole beneficiary**

If the RIF plan holder has named their Partner as the sole beneficiary of the RIF; and the latter instructs the RIF carrier to transfer the entire "eligible" part of the RIF directly to their own registered plan BEFORE December 31 of the year following the year of death. Such amount being transferred is called a "designated benefit". The "eligible" amount refers to the portion of the RIF passing to the surviving Partner less any minimum RIF amount for the year of death that has not been paid out. In this case, the surviving Partner will receive a T4RIF slip for the amount transferred, which must be reported as income for the year but will be offset by an official receipt for the amount transferred.

4. **A qualified beneficiary is designated as beneficiary**

A "qualified beneficiary" includes the deceased RIF annuitant's Partner as well as a financially dependent child or grandchild.

<u>What constitutes "financial dependency"?</u>

If the income of a child/grandchild exceeds a specified amount, the presumption is that he/she is not financially dependent on the deceased. However, this presumption can be rebutted by factual evidence.

The specified amount is the federal basic personal amount in force for the year before death. For example, if death occurred in 2010, the relevant amount is the 2009 personal amount. If the child/grandchild is financially dependent by reason of physical or mental infirmity, the specified amount is the basic personal amount plus the disability amount of the preceding year.

In this case, the amounts received by such beneficiary will be included in the income of the recipient as a "designated benefit".

If the beneficiary is:

- the annuitant's Partner; or
- a financially dependent child or grandchild who is dependant because of a physical or mental infirmity,

the beneficiary can defer paying tax on the sum received by transferring it to their own registered plan or transfer it to an eligible annuity. Such transfer or purchase must be completed in the year the designated benefit is received or within 60 days after the end of the year. The financial institution receiving the transferred amount will issue an official receipt to the qualified beneficiary so that they can claim a deduction on their tax return for the year they receive the designated benefit.

However, if the financially dependent child or grandchild is not physically or mentally infirm, the only transfer option is to an annuity that provides for payments based on a period of not more than 18 years minus the child or grandchild's age at the time of the annuity purchase; and payments from the annuity must begin no later than a year after the purchase. This means that the beneficiary will be taxed as the annuity payments are received.

Planning point

Bertha Bond (age 80), a wealthy widow, wishes to leave her large RIF (current value $500,000) to her granddaughter Yvette Monitz. Yvette is 13 years old and is the only child of Bertha's daughter, Dr. Larissa Monitz, a successful ophthalmologist. Bertha would like to save on probate taxes by making Yvette her designated beneficiary. She is also under the impression that there is a tax deferral because Yvette is her grandchild. What do you tell her?

Last Revised: February 22, 2010

First of all, there is the issue of whether Yvette is "financially dependent" on Bertha. The CRA will not normally accept that a grandchild is financially dependent on a grandparent where the grandchild lives with his or her parents who can adequately provide for the grandchild's well-being.

Furthermore, even if financial dependency could be established, unless the grandchild is dependant because of a physical or mental infirmity, the only rollover option is to transfer to an annuity to age 18. Since Yvette is already 13 years old, the tax deferral would only be available for 5 years. It may be more appropriate to explore other options such as establishing a testamentary trust for Yvette. This option would result in probate fees and income taxes on Bertha's death, but would allow Bertha to specify how the assets should be managed and distributed, and may provide ongoing tax savings.

What are the main differences between naming your Partner as successor annuitant versus RIF beneficiary?

As successor annuitant	As designated RIF beneficiary
The RIF is not collapsed but rather continues in the Partner's name as annuitant.	The RIF is collapsed upon the death of the RIF annuitant, and the RIF assets are transferred on a rollover basis to the registered plan of the Partner.
Minimum payments paid to the successor annuitant will be based on the same terms as when the RIF was originally set up.	The minimum payments will be based on the age of the owner of the new plan (i.e. the age of the Partner).
The book value of RIF assets remains unchanged where the Partner is the successor annuitant.	The FMV of the assets as of the date of the transfer will be the new ACB.

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