

MANTHORPE LAW OFFICES*

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Your Retirement Plan – RRSP Issues

We are all aware of the importance of the Registered Retirement Savings Plan (“RRSP”) as an important tax delay technique and retirement savings tool. However, as we focus on the choice of plan (eg. Deposit or self-directed), the amount to be invested (maximum permitted versus amount available) and rate terms, it is to overlook the issue of **naming a beneficiary** of the RRSP in case of our death before we have drawn all the money out of our RRSP.

It is the essence of the RRSP that the tax otherwise payable on the income which has been invested in the RRSP has been delayed until the funds are drawn out of the plan. However, in the case of the death of the RRSP holder, the *Income Tax Act* (“ITA”) requires that the value of the RRSP at the time of death be included in the deceased’s final income tax return for the result, the death triggers tax on the RRSP in the hands of the deceased which is a debt of the deceased’s estate.

It is possible to continue the delay in payment of the tax arising from collapse of the RRSP fund and transfer that tax liability to someone else if you name as beneficiary of the RRSP (either on the RRSP application or by specific bequest under the Will):

1. **Your Spouse**, provided the spouse immediately transfer the funds into their own RRSP or RRIF. “Spouse” would be given the extended definition accepted under the ITA, including common law relationships.
2. **Your Children or Grandchildren who are financially dependent on you at the time of your death.**
 - a. If the child/grandchildren is dependent on you for support due to mental or physical infirmity, the amount received can be transferred to their RRSP (therefore the funds would not be taxable until they withdraw the funds).
 - b. If the dependent child/grandchild is not physically or mentally infirm and is under 18 years, the RRSP can be rolled into an annuity for the child provided the annuity is for a fixed-term which does not extend beyond the year in which the child turns 18. The annuity payment will be taxable to the child in the years they are received. If the child is already a teenager and the amount they receive from

your RRSP is substantial, that in itself may trigger substantial income tax, although probably less than that which your estate would have paid.

It may also be possible to effect transfer of the RRSP to your spouse or dependent child or grandchild by agreement between the estate representative and that special class of beneficiary.

A recent case under the *Income Tax Act* (“ITA”) profiles the unexpected tax results of not being careful in the nomination of beneficiaries. The case dealt with circumstances where an RRSP holder named the three adult children of his first marriage as beneficiaries of his RRSP and left his second wife as the residual beneficiary of his estate under his Will. The risk highlighted by the case arises where the RRSP holder names beneficiaries of the RRSP who do not fall into the privileged categories outlined above, such as independent adult children. They should be able to receive the face amount of the RRSP (although not transfer it to their own RRSP), but the **Deceased’s estate** will be liable for the tax arising from collapse of the plan. In this case the Court held that the children could receive the full face amount of the RRSP while the amount the wife received under the Will was reduced by the tax payable by his estate due to the collapse of the RRSP. It is only if the estate has insufficient resources to pay the income tax that CCRA can look to the beneficiaries of the RRSP for payment

In short, the nomination of the three adult children as beneficiaries had a significant unintended impact on the estate and jeopardized the estate planning expressed by the Will. In some cases that may effectively bankrupt the estate, leaving nothing for those for whom the deceased wanted to provide the most.

Conclusion: If you are planning to choose a beneficiary for your RRSP **other than your spouse** you should give careful consideration to the possible unintended – and expensive – consequences. The default option is to name your “estate” as the beneficiary of the RRSP and focus your family, friends, and charitable donations through your Will, using the net proceeds of your estate after paying all your debts and taxes, including those payable due to collapse of your RRSP.

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Please call **Rosalyn Manthorpe** to discuss your estate planning needs.

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