

Dealing with RRSP, RRIF losses

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In Canada, when an individual dies, he or she is deemed to have sold their assets just before death – a sale that generally results in tax payable by the deceased's estate. For non-registered assets such as personally held stocks, bonds, mutual funds and recreational real estate, the tax is generally based on the difference between the fair market value of the asset at the time of death and the original cost. For registered assets such as RRSPs and RRIFs, tax is generally based on the value of the plans at the time of the annuitant's death.

Because death, like tax, can be difficult to deal with, it is not unusual for a delay to occur between the time of death and the distribution of a deceased's assets to beneficiaries. The delay can occur for various reasons including emotional stress, tension amongst family members or even a lack of knowledge of the existence of a particular asset.

If such a delay occurs, what are the tax implications of the delay? This article discusses the distribution of RRSPs and RRIFs after death, and highlights recent changes to tax law that are meant to reduce taxation of a deceased annuitant's estate. For purposes of this discussion, references to RRSPs and RRIFs are to trustee plans typically distributed prior to maturity (eg. generally, RRSPs and RRIFs issued by mutual fund companies).

For RRSPs and RRIFs, the deemed sale that occurs at death generally results in tax to the deceased's estate for the year of death. Exceptions generally apply where a spouse, common-law partner, or financially dependent child inherits the RRSP or RRIF. The tax liability is based on the value of the RRSP or RRIF at the time of death. Consider the following example:

After a long battle with a rare liver disease, Kim passed away. At the time of death, her RRSP had a value of \$125,000. Her adult son Steve, a successful entrepreneur who did not depend on Kim financially, was the sole beneficiary listed on the RRSP contract. Because Kim was deemed to have sold her RRSP just before her death, \$125,000 was reported on her final tax return and was subject to tax based on her marginal tax rate for the year of death.

After the passing of an RRSP/RRIF annuitant, if there is a delay between the time of death and the distribution of the RRSP/RRIF to beneficiaries, the RRSP/RRIF may experience an increase or decrease in market value. In the case of an increase, the value of the RRSP/RRIF on the date of the annuitant's death would remain taxable to the deceased. The increase after death would be taxed to the beneficiary of the RRSP/RRIF. For these purposes, if a beneficiary is not named on the RRSP/RRIF contract, or if a contract designation is not valid in the deceased's province of residence such as in Quebec, the beneficiary would be the estate of the deceased.

Steve had a difficult time coming to terms with Kim's death. Not wanting to address the reality of the situation, nine months passed before he requested the distribution of Kim's RRSP. Between the time of death, which occurred in January, and the distribution of the plan in September, Kim's \$125,000 RRSP increased to \$135,000. When paid to Steve in September, the RRSP administrator issued two T4RSP tax receipts – one in the name of the deceased (Kim), and a second in the name of the beneficiary (Steve). Kim's receipt showed an amount of \$125,000

that was taxable on her final tax return. Steve's receipt showed an amount of \$10,000, taxable to him in the year of the RRSP payment.

Seeing that Kim's RRSP was worth \$135,000 at the time of distribution, and understanding that RRSP income is fully taxable in Canada, the tax implications outlined above seem reasonable. But what would happen if the circumstances were different? What if Kim's RRSP decreased in value after death instead of increasing? Prior to 2009, the tax implications for this situation were as follows:

After Kim's death, in the nine month period before her RRSP was distributed to Steve, the RRSP decreased in value from \$125,000 to \$100,000. At the time of distribution, a T4RSP with an amount of \$125,000 was issued in the name of Kim. This amount was reported on Kim's final tax return and was subject to tax based on her marginal tax rate. Since there was no increase in Kim's RRSP after her death, no tax was payable by Steve.

Note, from the above example, that Steve received \$100,000 from Kim's RRSP. This represented the fair market value (FMV) of the RRSP at the time of distribution. Also note that Kim was required to include \$125,000 on her final return and pay tax on this amount based on her marginal tax rate. This represented the value of the plan at the time of Kim's death. Prior to 2009, there was no provision to recognize losses experienced in an RRSP or RRIF (\$25,000 in the above example) after death and before distribution to beneficiaries. Therefore, Kim was required to pay tax on the full date of death value of the RRSP even though Steve received an amount that was \$25,000 less.

The 2009 federal budget addressed this issue by announcing that, effective for RRSP and RRIF distributions that take place after 2008, RRSP/RRIF losses experienced after death will be recognized on the final tax return of the deceased annuitant. Specifically, although the date of death amount will still be reported on the final return of the deceased, an offsetting deduction will also be allowed. The deduction will generally be calculated as the difference between:

- the FMV of the RRSP/RRIF at the time of the annuitant's death
- the total of all amounts distributed from the RRSP/RRIF after the annuitant's death

The result of this provision is that the amount actually received by the beneficiary of the RRSP/RRIF will be taxed to the deceased instead of the higher date of death amount. The following example illustrates this point – assume an RRSP distribution after 2008.

After Kim's death, in the nine month period before her RRSP was distributed to Steve, the RRSP decreased in value from \$125,000 to \$100,000. At the time of distribution, \$100,000 was paid to Steve as beneficiary of the account, and a T4RSP for \$125,000 was issued in the name of Kim. This amount, \$125,000, was reported on Kim's final tax return. The RRSP issuer also completed CRA form RC249, Post-Death Decline in the Value of an Unmatured RRSP or RRIF – Final Distribution made in 20__, and issued it to the representative of Kim's estate. This form confirmed the amount paid to Steve, and was filed with Kim's final tax return to support her deduction for the post-death loss in the RRSP. The result? Kim's estate paid tax on \$100,000 (the amount distributed from the RRSP) as opposed to \$125,000 (the date of death amount).

When working with clients, and representatives for deceased clients, keep in mind that the deduction for post-death losses in RRSPs and RRIFs are generally not available where the RRSP/RRIF held non-qualified investments after the annuitant's death. Non-qualified

investments generally include land and certain private corporations. Also, to be eligible for deduction, the RRSP/RRIF distribution must take place before the end of the year following the year of the annuitant's death.

Dealing with death is challenging, and adverse tax implications can further complicate matters. As a financial advisor, when a client passes away, you may become the first point of contact for family members – so it is a good idea to stay abreast of legislative changes that could impact their estate. The ability to deduct post-death RRSP and RRIF losses is a significant change, and a new tool for your tool kit. Hopefully it won't get a lot of use – particularly if investments go the right way – but there is comfort in knowing that there is some relief should losses be sustained.