



RRSPS, RRIFs AND WITHHOLDING TAXES AT DEATH

Why do withholding taxes not apply to RRSP and RRIF proceeds paid to beneficiaries on death of the plan annuitant? The short answer is, there is no requirement for it under the Income Tax Act (ITA).

In Canada, payers of taxable income are normally required to withhold a certain amount of tax when paid to recipients. The amount of withholding varies depending on the type of income and amount paid. There are exceptions to the rule, including payments of interest and dividends to Canadian residents. RRSP and RRIF payments to annuitants are normally subject to a withholding tax of up to 30% depending on amount and, in the case of a RRIF, only amounts in excess of the RRIF minimum for the year are subject to the withholding.

Generally, for Canadian residents, withholding taxes represent a tax prepayment. Any refund or additional tax payable on the income would be addressed when the tax return for the year is filed. For non-residents, withholding taxes often represent the non-resident's final tax obligation to Canada on the income.

Where the annuitant of an unmatured RRSP or RRIF dies, unless transferred on a tax-deferred basis to certain registered plans for a spouse, common-law partner (CLP) or financially dependent child or grandchild, the value of the RRSP/RRIF at the time of death – the date of death amount – is deemed received by the annuitant just before death. This results in taxable income for the deceased for the year of death equal to that amount. We commonly see this when parents or grandparents die with RRSPs and RRIFs for which their children or grandchildren are beneficiaries. Where the beneficiaries are entitled by way of their designation on the RRSP/RRIF contract¹, RRSP/RRIF issuers normally pay the proceeds directly to the beneficiaries free of withholding taxes, even though

the amounts are taxable. Consider the following example:

At the time of her death, Mae's RRIF had a value of \$400,000. As per the RRIF application, her beneficiary was her daughter, Grace. Mae also had a Will in which she named her other two children, Jacob and Charity, sole beneficiaries of her estate. Mae's Will made no reference to her RRIF.

Shortly after Mae's death, Grace approached the RRIF issuer and requested payment from the plan. The issuer paid Grace \$400,000 – there was no change in the value of the RRIF between the date of Mae's death and payment to Grace – and a T4RIF was issued to Mae's executor requiring \$400,000 to be included as taxable income on Mae's terminal tax return for the year of death, payable by her estate. As a result, Grace received \$400,000 free of withholding taxes while Jacob and Charity paid the taxes for the payment via a reduction of their entitlement from Mae's estate.

Setting aside the discussion about the importance of planning for taxes, especially where estate and registered plan beneficiaries are different, the question of withholding taxes often comes up when settling RRSPs and RRIFs at the time of death. At first blush, one might think that withholding taxes would apply to the \$400,000 payment to Grace given that the amount was taxable. After all, withholding taxes normally apply to RRSP and RRIF amounts paid to annuitants before death. What, then, makes things different for payments made as a result of death?

As mentioned earlier, when an RRSP or RRIF annuitant

¹ In Quebec, RRSP and RRIF plan level designations are not normally allowed. Beneficiary designations in Quebec are normally made by way of a will.

dies, unless transferred on a tax-deferred basis to certain registered plans for a spouse, CLP or financially dependent child or grandchild, the ITA 'deems' the annuitant to have received the value of the RRSP or RRIF just before death. This amount normally becomes fully taxable to the deceased for the year of death² with the tax payable by his/her estate. When a beneficiary requests payment from the plan, as per CRA technical interpretation #9931685, withholding tax does not apply to the date of death amount for the following reasons:

- i. Withholding tax normally applies to taxable amounts 'paid' from RRSPs and RRIFs³. In the case of death, while taxable, the date of death amount is 'deemed received'. Thus, there is no payment from which withholdings can apply.
- ii. Where date of death amounts are taxed to the deceased, payments to beneficiaries are tax-free. Because these payments are tax-free to beneficiaries, there is no requirement to withhold tax from them.

Exceptions to the rule apply in certain non-resident scenarios – namely, where the deceased annuitant was a non-resident at the time of death, and also where the named beneficiary is a non-resident and the payment is in respect of growth accrued in the RRSP/RRIF between the date of death and payout. In these situations, a non-resident withholding tax normally applies. Outside of these scenarios, the absence of withholding taxes for RRSP and RRIF death settlements can create complexities for families.

MORAL OF THE STORY

The moral of the story is that it is important to plan for taxes at the time of death. Where withholding taxes during one's lifetime can help to avoid surprise and hardship at tax-filing time, payments from RRSPs and RRIFs at death don't normally receive the same treatment. Planning considerations might include life insurance to cover taxes and/or equalize entitlements for plan and estate beneficiaries, or consistent beneficiaries across all assets. Discussing intentions with financial advisors and family can help to uncover potential conflicts and challenges.

² There is flexibility to tax the date of death amount in the hands of a spouse, common-law partner or financially dependent child or grandchild for the year of death provided he/she is a beneficiary of the asset.

³ RRIF minimum amounts are an exception to the rule.

Visit us at ci.com/en/tax-retirement-and-estate-planning
For more information, speak to your CI sales team.



IMPORTANT DISCLAIMERS

This communication is published by CI Global Asset Management ("CI GAM"). Any commentaries and information contained in this communication are provided as a general source of information and should not be considered personal investment advice. Facts and data provided by CI GAM and other sources are believed to be reliable as at the date of publication. Certain statements contained in this communication are based in whole or in part on information provided by third parties and CI GAM has taken reasonable steps to ensure their accuracy.

Market conditions may change which may impact the information contained in this document. Information in this communication is not intended to provide legal, accounting, investment or tax advice, and should not be relied upon in that regard. Professional advisors should be consulted prior to acting on the basis of the information contained in this communication.

You may not modify, copy, reproduce, publish, upload, post, transmit, distribute, or commercially exploit in any way any content included in this communication. You may download this communication for your activities as a financial advisor provided you keep intact all copyright and other proprietary notices. Unauthorized downloading, re-transmission, storage in any medium, copying, redistribution, or republication for any purpose is strictly prohibited without the written permission of CI GAM.

CI Global Asset Management is a registered business name of CI Investments Inc.

©CI Investments Inc. 2021. All rights reserved.

Published April 9, 2021

21-03-270122_E (03/21)