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TAX MATTERS

Choose your RRSP or RRIF beneficiaries carefully

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It was almost 36 years ago that Luis Carlos de Noronha Cabral de Camara, of Portugal, left his estate to 70 people that he had randomly chosen out of a Lisbon phone book. Since he had no spouse or children, he chose 70 lucky people who were named in his will to receive his assets, which consisted of a 12-room apartment in central Lisbon, a house near the northern town of Guimaraes, a couple of healthy bank accounts, a luxury car and two motorbikes. Each beneficiary walked away with several thousand euros.

Wouldn't it be fun do the same with your RRSP or RRIF? Well, hold on – if you do have a spouse or kids, you might want to consider a different idea. Today, I want to talk about options for naming beneficiaries of your RRSP or RRIF.

Tax on Death

The general rule is that, when you die, you'll face tax on the fair market value of the assets in your RRSP or RRIF. This can result in a big tax liability. It's not uncommon, for example, to pay tax at the highest marginal tax rate on your plan assets in your year of death, which could mean that about half of those assets may be owing to the taxman.

There are exceptions to these rules where you designate a certain person, or more than one, as the beneficiary of your RRSP or RRIF.

Naming Your Spouse

If you have a spouse or common-law partner it's most common to name that person as the beneficiary of your RRSP or RRIF. The reason? Your spouse can wind up your plan upon your death and transfer the plan assets to his or her own RRSP or RRIF, or purchase an annuity, on a tax-deferred basis. Your spouse won't face tax until funds are withdrawn from his or her RRSP, RRIF or when annuity payments are received.

Your spouse will have to make a transfer of your plan assets to his or her own plan by Dec. 31 of the year following the year in which you die. Any minimum RRIF payment for your year of death that wasn't paid to you will be paid as taxable income to your spouse (so, the minimum withdrawal amount can't be transferred tax-free to the surviving spouse's plan).

If you have very little income in your final year, or have losses to use up, it could make sense to not transfer all of your RRSP or RRIF assets to your spouse's plan. Rather, allowing some of your plan to be taxable in your year of death could allow for the using up of tax credits, deductions, or losses that might be available. Your executor can choose the amount to be taxed on your final return.

When it comes to an RRIF (not an RRSP), you have the option of naming your spouse as the "successor annuitant" instead. In this case, your RRIF continues to exist after your death (as opposed to being wound-up and the assets transferred to your spouse's plan) and your spouse becomes the annuitant. Administratively, this is much easier. And if you happen to be younger than your spouse then your spouse can continue making withdrawals based on your age schedule rather than his or her own, which will allow for a longer deferral of tax.

Naming Dependents

You can also defer tax if you name a financially dependent minor child or grandchild, or one that has a mental or physical infirmity, as beneficiary of your RRSP or RRIF. Your child or grandchild must have lived with you and depended on you just prior to your death. Further, their net income for the year before your death must generally have been less than the basic personal amount ($15,000 in 2023) plus, where they have a disability, the disability amount ($9,428 in 2023). It may be possible to demonstrate financial dependence if the child's or grandchild's income is above these amounts, but it would have to be proven with facts and circumstances.

If a child or grandchild qualifies, your plan assets can be transferred tax-deferred to their RRSP or RRIF, or be used to purchase an annuity. In the case of minors, your only option is to use the plan assets to purchase a term-certain annuity that will pay out on a taxable basis by the time the child is 18.

If your child or grandchild has a disability, it may be possible to transfer your plan assets to a registered disability savings plan (RDSP), or to a Lifetime Benefit Trust (LBT) if the child has a mental impairment, where the LBT can purchase a "qualifying trust annuity" to pay out over the life of the child.

Next time, I'll share other ideas related to naming beneficiaries.

I've been writing about the five pillars of tax planning over the last few weeks. This week I want to talk about the fifth pillar: "Dodging" to save tax. Don't worry – it's not illegal. I'm talking about structuring your affairs so that certain types of income won't be taxable to you at all.

As I was thinking about this concept of "dodging," I couldn't help but recall the movie Dodgeball where a character said "Remember the five Ds of dodgeball: Dodge, duck, dip, dive and dodge." As uncanny as it might seem, the five Ds in tax planning are pretty similar concepts: Deduct, defer, divide, disguise and dodge. Now, let's look at ways to "dodge" taxes.

Use a tax-free FHSA. First-time homebuyers will be able to open a Tax-Free First Home Savings Account (FHSA) starting this year. Talk to your financial institution about when they'll be available – it should be very soon. The FHSA allows a first-time homebuyer (someone who, along with their current spouse, hasn't owned a home in the year

the FHSA is opened, or in the preceding four years) the ability to contribute $8,000 annually to an FHSA, up to a limit of $40,000 in a lifetime. The contributions are deductible, and you won't face tax on any growth or income in the plan, or on withdrawals as long as the money is put toward a home purchase. It's a great deal. See my article from Aug. 25, 2022, for more tips.

Negotiate non-taxable benefits. Although benefits provided by your employer are generally treated as taxable, certain ones could be tax-free. These benefits can include some education costs, costs of counselling, certain membership fees to social or athletic clubs, relocation expenses, a portion of cellphone service costs, employer-provided daycare, gifts and awards ($500 or less per year), parking costs (in some cases), and loans from your employer, or interest subsidies (i.e. your employer could arrange for a mortgage or financing for you and could make payments to the lender for part of your interest costs). For these last two benefits, there will be no taxable benefit as long as the interest cost you pay personally remains at or above the prescribed rate under our tax law (currently 4 per cent).

Ask for a tax-free death benefit. It's possible for your employer to pay up to $10,000 in tax-free cash to your surviving beneficiary at the time of your demise. As long as the payment is made after your death in recognition of your service as an employee, then the payments can be tax-free.

Invest in a tax-exempt life insurance policy. Our tax law will allow you to accumulate investments inside a life insurance policy, similar to a tax-free savings account. For each dollar you pay in premiums on the policy, a portion goes to cover the mortality charge – that is, the cost of insuring your life – but part of the premium can go into a growing pool of investments. You won't face tax on the income earned in the policy, and the accumulating funds will be paid out tax-free upon your death. The policies that allow this type of accumulation are "whole life" or "universal life" insurance policies. Term insurance policies (the cheapest insurance available) won't allow for accumulating investments inside the policy.

Use a second will to avoid probate fees. Probate fees are levied by many provinces and territories and are, by any other name, a tax. These fees apply when you pass away and are generally calculated as a percentage of your assets that pass through your will. You may be able to avoid probate on certain assets that don't require probate by using a second, separate, will to deal with those assets, and using a primary will to deal with everything else you own. Private company shares are an example of an asset that can have a high value and could be passed to your heirs by a separate will that doesn't have to go through probate. Speak to a lawyer in your province or territory about this type of planning.

Extract funds from your corporation tax-free. If you own a corporation there may be ways to withdraw amounts from it without paying tax. Consider taking a repayment of shareholder loans owed to you by your company, borrowing from the corporation in certain situations, paying yourself capital dividends, or withdrawing paid-up capital from your company (speak to a tax pro about these ideas.) These moves are all potentially tax-free. You might also consider having your company pay you rent for office space in your home that's used for corporate business. You'll have to report these rents as income, but you may have enough expenses to fully offset this income, making it effectively a tax-free withdrawal from your company.

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