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TAX MATTERS

Two smart RRIF strategies to consider as part of your estate planning

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My grandfather told me the story of making his funeral arrangements. The cemetery salesman showed him a plot and assured him, "You'll have a wonderful view of the pond and the swans." Grandpa replied, "Well, I hope you're going to include a periscope with the casket, otherwise I'm not sure how I'll enjoy it."

As for his will, Grandpa used to joke that it would be a very short document. He said it would simply read: "Being of sound mind, I spent all the money."

As it turns out, he left a registered retirement income fund (RRIF) to my grandmother, who in turn left those assets to her kids. Last week, I spoke about naming beneficiaries of a RRIF. Today, I'd like to finish that conversation and share another RRIF idea that you might consider as you get older.

The options

Last week, I talked about the tax bill that can arise if you don't name an appropriate RRIF beneficiary. Naming your surviving spouse, or a financially dependent child, as beneficiary can avoid a tax bill on your RRIF when you die.

Yet when it comes to a RRIF (but not an RRSP), you have a second option. You can name your spouse as the "successor annuitant" rather than a beneficiary. In this case, your RRIF continues to exist after your death (as opposed to being wound up, with the assets transferred to your spouse's plan), and your spouse becomes the annuitant. This is much simpler administratively.

Also, naming your spouse as the successor annuitant can allow you to control your RRIF assets after you're gone. For example, you can ensure that your surviving spouse receives an income from the RRIF but that your children will receive the balance of the RRIF when your spouse dies (good in a second marriage situation, for example).

How? By naming your spouse as the successor annuitant and your children as irrevocable beneficiaries of your RRIF. In this case, your spouse would need written permission of the irrevocable beneficiaries to change the beneficiaries, increase the RRIF withdrawals or cash in the investments. This idea can also make sense if your spouse becomes unable to manage their own affairs owing to a mental impairment. Be aware, however, that while you're alive, the same permission would have to be sought from those beneficiaries if you wanted to make changes.

By the way, if your spouse predeceases you or is no longer your spouse at the time of your death, the RRIF contract would terminate and the assets would be paid to your irrevocable beneficiaries. Speak to an estate lawyer about the pros and cons of this idea in your situation.

Why all the fuss over mandatory RRIF withdrawals?

The transfer

Now, for another idea. It normally makes sense to defer tax by deferring the withdrawals from your RRIF as long as possible. But in some cases, it could make sense to withdraw funds earlier and transfer those funds to a tax-free savings account (TFSA) over time.

Consider an example. Wilma and Betty are sisters, both single. They turned 72 last year, and each has a RRIF. Let's assume they can earn 5 per cent annually on their investments and have a marginal tax rate of 30 per cent. Let's also assume they both live to age 90 and will face tax in their year of death at a marginal rate of 50 per cent (their incomes will be high in the year of death owing to their RRIFs becoming taxable).

Wilma has decided to start withdrawing extra funds from her RRIF each year (over and above what she needs to live on) and will contribute these extra funds to her TFSA. She will withdraw an extra $9,285 from her RRIF, which, at her marginal tax rate, leaves her with $6,500 to contribute to her TFSA. She will have $182,860 in her TFSA at age 90 with our assumptions. She won't face tax on it when she dies, so the after-tax value to her estate will be $182,860.

Betty is taking a different approach. She's going to keep the $9,285 in her RRIF each year. By the age of 90, those dollars will have grown to $261,200. Taxes at the time of Betty's death on these RRIF assets will be $130,600, leaving her estate with just $130,600.

So the end result is that Wilma will leave $52,260 more to her heirs than Betty.

This idea can make sense when you expect a much higher marginal tax rate upon death than you face today, you expect significant RRIF assets still around when you and your spouse are gone and you otherwise have TFSA contribution room you may not be utilizing.

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