

TODAY'S ISSUES



TODAY'S ISSUES is produced three times a year by Personal Wealth Strategies. It is a commentary on important taxation, business and economic matters of interest to clients and business associates of Personal Wealth Strategies. ed.4/05

DESIGNATING RRSP AND RRIF BENEFICIARIES

An area of tax planning that often does not receive enough attention is the designation of beneficiaries in Registered Retirement Savings Plans (RRSP) and Registered Retirement Income Funds (RRIF). The taxation of the proceeds of these plans on death seems to be equally problematic. Finally, most people don't understand that a RRIF is not a continuation of an RRSP but a new contract requiring its own beneficiary.

Beneficiary Designations

An RRSP is a special contract under the Income Tax Act. At the time of signing the contract, the plan holder designates one or more beneficiaries. Sometimes this is done rather casually and the recollection of the exact beneficiary years later may not be accurate.

When an RRSP was purchased, an individual may have chosen to leave the proceeds on death to his estate - perhaps because there was no spouse or other immediate family members and the owner wished to handle everything through his will. Years later, the individual in the course of estate planning, prepares a new will and may now be married with children but for whatever reason does not name a new beneficiary in his RRSP plans or consider the issue when drafting the new will. He or she just may not have the correct recollection of the original RRSP beneficiaries - but without a new designation the proceeds may pass to unintended individuals. In a recent discussion with an investment advisor, we learned that this is a problem seldom properly attended to after a divorce.

Everyone should look at wills and RRSPs periodically to make sure that the right beneficiaries are in place. If you haven't done it for a while, pull out all of your RRSP plans and your will and check to see that the beneficiaries are the ones intended. We understand that if there are designations both under the will and the RRSP itself, the designation in the RRSP is the one that counts - no matter which one was done last.

Taxation of RRSP Proceeds

A common misconception is that RRSP proceeds are taxable to the RRSP beneficiary on the death of the plan holder - which is not the case. RRSP proceeds on death are taxable on the final return of the plan holder and obviously the resulting tax can encroach on the estate capital intended for other beneficiaries. If the deceased believed that the tax was payable by the RRSP beneficiary, a huge imbalance would develop between the intended allocation of estate capital amongst beneficiaries and the actual allocation. Assume, for example, that an individual has \$500,000 in his or her RRSP on

death and designates the RRSP proceeds to two of his children. Tax on the RRSP proceeds of up to \$225,000 would come out of the estate. Should the decedent not understand this, the capital going to non RRSP beneficiaries would be unfairly reduced.

RRSP Conversion to RRIFs

RRSP plan holders must choose whether to convert RRSPs into an annuity or a RRIF or possibly both, by December 31 of the year in which an individual reaches age 69. Most people choose the RRIF option so as to have better control over their funds in future and retain the RRSP capital for family in the event of early death. As mentioned earlier, both the RRIF and annuity are new instruments so a beneficiary designation is required.

Problems have shown up in recent court decisions in British Columbia because an RRSP owner failed to make an appropriate beneficiary designation in the RRIF at the time the RRSP was converted. Sometimes this can simply be an oversight in the hurry of getting things done at the last moment or perhaps the plan holder is not careful enough in bringing his current wishes to the attention of the RRIF issuer. In any event, disaster can strike since the designation in the RRSP does not carry over when a RRIF is created.

Another problem has come to light in recent court cases where the owner of an RRSP becomes incompetent and the affairs of the RRSP owner are assumed by someone else under a Power of Attorney. Because the owner of the RRSP is no longer competent to make legal decisions, the question is whether the power to make a beneficiary designation can be assumed by the attorney. A recent court case in British Columbia held that the attorney does not have that power so the designation made in the RRIF by the attorney (even if the same as the RRSP) was held to be invalid. Essentially, case law at this time indicates that choosing a beneficiary is not an act that can be performed under a Power of Attorney.

The decision to change or create a beneficiary must be done by the plan owner. If an individual is incompetent at the time that the RRIF designation is required, it appears that the beneficiary of the RRIF can only be the estate of the plan owner. It may be possible to make an application to the courts to have the designation of the RRIF the same as beneficiaries of the RRSP if that was intended. In the case of individuals falling into bad health, it would be desirable for them to make the conversion to the RRIF while still competent to do so.

Our experience indicates that this whole area of beneficiary designation is one that is simply not given enough attention. Check it out! *This Today's Issues was written as an article for MoneySaver magazine.*

*J. E. Arbuckle Financial Services Inc.
30 Dupont St. E., Suite 205, Waterloo, Ontario N2J 2G9
Phone: 519-884-7087 Fax: 519-884-5741
Email: info@finplans.net*

