



October 19, 2004

Mr. Len Farber
General Director
Tax Legislation Division, Tax Policy Branch
Department of Finance Canada
140 O'Connor Street
Ottawa ON K1A 0G5

Dear Mr. Farber:

Re: Rollover of RRSP's and RRIF's to a Trust for Spouses and Disabled Financially Dependent Children

I am writing on behalf of the National Wills, Estates and Trusts Section of the Canadian Bar Association (CBA Section), to support an amendment to the Income Tax Act pertaining to the rollover of a Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF).

The CBA is a national association representing over 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

The CBA Section proposes the following amendments to the *Income Tax Act*:

- The rollover of an RRSP or RRIF to a trust for a spouse (including a common-law partner).
- The rollover of an RRSP or RRIF to a trust for a financially dependent child or grandchild.

The first issue was presented at a meeting in October 2002 with Department of Justice officials. The second issue arises out of the December 2002 technical amendments to section 60(1) of the *Income Tax Act*.

A. ROLLOVER OF AN RRSP OR RRIF TO SPOUSES

Background

As estate lawyers, members of the CBA Section encounter difficult estate planning issues with second marriages and second common-law relationships, especially where there are children from the first relationship. Testators will usually be motivated to ensure that their second spouse or partner has adequate income but want the capital of their estate to be transferred to their children from the first marriage upon the death of both spouses. The spousal trust is an excellent tool in these circumstances. It allows the estate to be invested for the benefit of the surviving spouse for life, with all the income paid to the spouse for life and the power to encroach on capital if the income is insufficient. Upon the death of the second spouse, there is a deemed disposition of the assets with the tax payable by the estate of the first spouse to die.

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The difficulty is that an RRSP or RRIF cannot be rolled over to a spousal trust. With significant amounts being accumulated in RRSP's and RRIF's in many estates, this is a substantial roadblock to estate planning.

Proposal

The CBA Section proposes the following:

- i. An individual could designate a trustee to hold an RRSP or a RRIF on trust for a surviving spouse or partner for the life of the spouse or partner. The trustee would have control over withdrawals from the RRSP and when the surviving spouse or partner reaches age 69 would be required to convert the RRSP to a RRIF.
- ii. The amendment would allow the RRSP or RRIF to continue in the same form, rather than requiring the trust to purchase an annuity (as is the case for dependent children under s. 60(l)). This would give the trustee the discretion concerning investments in the trust and to decide if and when an encroachment would be made by a withdrawal from the RRSP. This is the same tax effect as if the RRSP or RRIF were rolled over absolutely to the spouse or partner.
- iii. Any withdrawal from an RRSP or RRIF could be required to be paid to the surviving spouse or partner and therefore be taxed in his or her hands. In the alternative, it would be useful to enable such funds to continue to be held in the trust with the trustee retaining discretion to use the funds for the benefit of the surviving spouse or partner. From a tax perspective, there might be a requirement that any withdrawal from the RRSP or RRIF be taxed in the hands of the surviving spouse or partner and perhaps even a requirement that withdrawals be vested absolutely in the name of the surviving spouse. The result would be that such withdrawals would form part of the estate of the surviving spouse on his or her death. The balance of the capital remaining in the trust on the death of the spouse could then be divided among the alternate beneficiaries (for example, the children from the first marriage).
- iv. On the death of the surviving spouse, the RRSP/RRIF would be taxed in the hands of the first spouse (the testator) in the T3 return of the testator in the year of the death of the second spouse. The tax would be paid at the graduated rates of the testamentary trust, in that year.

Revenue Neutral

The result of this proposal is revenue neutral:

- With the current rules, withdrawals from an RRSP or payments from a RRIF are taxed in the hands of the surviving spouse who owns the RRSP or RRIF. With our proposal, withdrawals from an RRSP or payments from a RRIF are taxed in the hands of the surviving spouse, but the RRSP or RRIF will be owned by the trust.
- With the current rules, the RRSP or RRIF will be taxed as income in the hands of the surviving spouse on the death of that spouse (unless there is a further rollover to a dependent child). With our proposal, the RRSP or RRIF will be taxed as income in the estate of the first spouse to die, in a manner similar to the taxation of the assets in a spousal trust on the death of the second spouse (unless there is a further rollover to a dependent child). In some circumstances, this could result in more tax than if taxed in the hands of the second spouse to die.

B. DISABLED CHILDREN AND GRANDCHILDREN

i. December 2002 Technical Amendments to Section 60(l)

Technical amendments to the *Income Tax Act* were introduced in December 2002 to allow for an RRSP or RRIF to be rolled into a trust for a dependent disabled child by the purchase of an annuity by the trust for the child. These changes were welcome. We submit, however, that the changes do not allow enough flexibility in estate planning for disabled children.

ii. Use of a Trust for RRSP's and RRIF's for Dependent Disabled Children

The rollover available to a child or grandchild who is financially dependent on a deceased taxpayer by reason of physical or mental disability is essentially the same as the rollover available to a spouse. The disabled child may rollover the refund of premiums to an RRSP or RRIF or an annuity. Prior to the technical amendments, it was our understanding that the funds must vest absolutely in the name of child in order to achieve this rollover.

The difficulty with absolute vesting is that if the disabled child is mentally disabled, that child will not likely be capable of managing RRSP investments or deciding when it is prudent from a tax perspective to make a withdrawal from the RRSP. It is therefore appropriate for the parents to establish a trust in their wills whereby all of the money will be held on trust for the child with power for the trustee to encroach upon income or capital when appropriate.

Most parents with disabled children would want to control the eventual disposition of the RRSP upon the death of the disabled child. A trust for the disabled child allows this. Upon the death of the child, the trust can provide a gift over to the other children or other beneficiaries.

We propose that the *Income Tax Act* permit the rollover of the parent's RRSP or RRIF to an RRSP or RRIF or annuity held in a trust for a disabled child.

iii. Government Benefits for Disabled Adults and Use of Discretionary Trust for Disabled Children

Most provinces provide a benefit payable to disabled persons to provide for their day-to-day living needs. If that individual receives income or capital, including interest or employment income, that exceeds a certain amount per month, the benefit will be reduced. It is therefore important to provide for the child in a manner that will not reduce this government benefit. Increased flexibility in the planning for a disabled child will allow a safety net for the needs of such a child, should such needs change in the future or should government funding change.

It is prudent for the parents of a disabled child to establish a discretionary trust in their wills for the child. The discretionary aspect of the trust is important for two reasons:

- The child is not capable of managing the inheritance and needs a trustee to manage the funds.
- In most provinces, this kind of a trust should allow the government benefit to continue to be paid to the child. This allows the trustees to maximize other available funding for the child. The trust therefore operates as a safety net in the event that government funding programs are later changed or if the child requires something extra beyond what is paid by the benefit program.

iv. Impact of Technical Amendments

Prior to the technical amendments, no provision in the *Income Tax Act* allowed the RRSP to be held in a discretionary trust described above. The amendments partially solve this problem, but restrict the solution to the purchase of an annuity in the trust for the dependent child. The difficulty is that the annuity pays income to the trust, which is taxed in the trust, if the income is retained in the trust. This may not always be appropriate. If the income is paid to the child, the child will pay the tax at his or her graduated rates. The problem is that the child's government benefits will probably be reduced. If the income is retained in the testamentary trust, the trust pays the tax without the benefits of the basic personal exemption. As a result, more tax is paid than if the RRSP were rolled to the child's RRSP. We propose that the *Income Tax Act* also allow for the rollover of an RRSP or RRIF to an RRSP or RRIF held in a trust for a disabled child, as well as an annuity.

We suggest that the *Income Tax Act* be amended in a manner similar to that suggested for spouses to allow a parent's RRSP or RRIF to be rolled over to an RRSP, RRIF or annuity held in a trust for a disabled child. Our proposal would work exactly the same as the proposal for a trust for a spouse.

The CBA Section's comments concerning revenue neutrality on spousal trusts apply equally to a trust for a disabled child. The funds would be taxed in the estate of the testator parent on the death of the child.

C. SUMMARY OF PROPOSED TECHNICAL AMENDMENTS TO THE *INCOME TAX ACT*

The following is a partial list of technical amendments to the *Income Tax Act* that may be required to give effect to our recommendations concerning a rollover to a trust for a spouse or for a financially dependent child or grandchild.

- i. **Amend section 60(l) by adding after (i):**
As a premium under a registered retirement savings plan under which a trust for the taxpayer is the annuitant, whereby the taxpayer is the sole person beneficially interested in amounts withdrawn from the registered retirement savings plan during the taxpayer's lifetime.
- ii. **Amend section 146(1) definition of "annuitant" by adding:**
A trust for the individual's spouse or common-law partner.
- iii. **Amend section 146(1) definition of "refund of premiums" to include:**
 - a. any amount paid to the trust for a spouse or common law partner of the annuitant.
 - b. any amount paid to a trust for a child or grandchild of the annuitant, who was at the time of death, financially dependent by reason of disability on the annuitant for support.
- iv. **Amend section 146(8.91) joint election:**
Where the trustee of the trust for a spouse or common law partner file with the minister a joint election in prescribed form.
- v. **Add a new subsection to section 146 after (8.8):**
When the spouse or common law partner dies, the trust for the spouse or common law partner shall be deemed to have received, immediately before the death of the spouse or common law partner, an amount as a benefit out of or under a registered retirement savings plan. (i.e. the trust is taxed on the benefit unless there is a financially dependent disabled child, in which case section 146(8.1) joint election may be made with the child)

Any benefit received from a registered retirement savings plan in a trust for the spouse or common law partner of the individual is taxable in the hands of the spouse or common law partner, and the spouse or common law partner must be entitled to receive all of the withdrawals from the registered retirement savings plan before the death of the spouse's or common law partner's death and, no person except the spouse or common law partner may, before the spouse's or common law partner's death, receive or otherwise obtain the use of any of the income or capital of the trust (in other words, copy the wording in section 70(6)).

- vi. **Add a subsection after section 146(8):**
Where a trust is the holder of a registered retirement savings plan for the spouse or common law partner, there shall be included in computing the income of a spouse or common law partner for a taxation year, the total of all amounts received by the trust in the year as benefits out of or under the registered retirement savings plans.
- vii. **Amend section 60(l)(iii) concerning registered retirement income funds in the same manner. In other words, allow registered retirement income funds to be held on trust for the benefit of the spouse or common law partner.**

We would be pleased to discuss these proposals with you in more detail. Please telephone me at your convenience at (780) 441 4334.

Yours truly,

(Original signed by Trevor M. Rajah on behalf of Philip J. Renaud, Q.C.)

Philip J. Renaud, Q.C.
Chair
National Wills, Estates and Trusts Section

CC Catherine Cloutier
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