

The RRSP and RRIF beneficiary designation solution for converting estate taxes to charitable donations



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The Canadian tax system provides generous tax credits for charitable donations. The reason the government provides these generous tax incentives and foregoes the tax revenue is to encourage Canadians to donate more to charities of their choice. Charities can harness the time and efforts of millions of volunteers and the voluntary donations of Canadians and achieve more than would be possible for our government to do merely by collecting taxes.

While like most Canadians you may donate to charities because you have a personal connection to the cause, want to make a difference and give back to your community, it is important that you take advantage of the tax incentives for charitable donations to maximize the impact of your donations during your lifetime and multiply your bequests.

RRSPs and RRIFs are a great way of saving for retirement on a tax deferred basis. You receive a tax deduction on the amounts that you contribute during your lifetime, the funds will grow tax sheltered until you withdraw them or age 71 at which time you must convert your RRSP to a Registered Retirement Income Fund (RRIF), and start withdrawing income from it and pay tax on the income.

However, RRSPs and RRIFs are the worst way to transfer wealth to the next generation and are a ticking time bomb when it comes to taxes. Upon the death of the first spouse the entire balance of an RRSP or RRIF will be rolled over on a tax-free basis to the surviving spouse. The problem occurs on the death of the second spouse. At that time the balance of the RRSP or RRIF is considered income in the year of death and will likely put the estate of the last spouse in the highest tax bracket. In 2019 in Ontario any income over \$220,000 is taxed at the highest marginal tax rate of 53.53%. Therefore, even if the last spouse to die has no other in-

come in the year of death, a modest RRSP or RRIF balance could easily put him/her in the highest marginal tax bracket.

One strategy that can help you leave a legacy to your charity of choice and maximize the amount of the total after-tax combined bequest and inheritance for your children is designating the charity (or charities) of your choice as one of the beneficiaries of your RRIF. This strategy would work in all provinces except for Quebec.

Let's consider the case of Mary, a very philanthropic retiree, to see how by using the 50% strategy, she can leave a generous charitable bequest to ensure that the charity she has supported all her life will receive a bequest from her with minimal reduction in the inheritance she wishes to leave for her children.

Mary is a 60-year-old widow and has \$500,000 in her RRIF. She is using the income from her RRIF to support her lifestyle. She has been a homemaker all her life and has no other source of income.

If she dies in 2019, she would end up paying approximately \$230,000 in taxes on her death on her RRIF, leaving her beneficiaries with only \$270,000 after tax.

If she changes the beneficiary designation of her RRIF and appoints her favourite charity as beneficiary for 50% of the assets (\$250,000) and leaves the other 50% or \$250,000 to her children. By naming the charity as a 50% beneficiary of her RRIF, Mary can leave a \$250,000 bequest for her favourite charity and the inheritance she is leaving her beneficiaries is only shrinking by \$125,000

(\$270,000 – \$145,000). Therefore, the \$250,000 legacy gift has only cost her estate \$125,000 and the inheritance she will leave to her beneficiaries is only reduced by this amount. Furthermore, the total after-tax inheritance and bequest that she would be leaving would be \$395,000 versus only \$270,000 if her children were the only beneficiaries of her RRIF.

Designating charities as beneficiaries of your RRSP or RRIF is a very quick and simple solution that can be implemented by completing a multiple beneficiary designation form with the financial institution where your RRSP or RRIF is held. It is a very flexible solution as you can change your mind and the amount that you wish to leave to each charity as often as you like without the need to update your will and thus allows you to save on the expenses involved.

A direct beneficiary designation will also mean that the money that goes to the named beneficiaries will bypass your will and will not be considered part of your estate. Therefore, the amount would not be subject to the 1.5% estate administration tax in Ontario, which is charged on estate assets over \$50,000.

While the RRSP/RRIF beneficiary designation strategy can be a very powerful strategy for maximizing the impact of your philanthropy and your charitable bequests, it needs to be taken into consideration in the context of your overall financial and estate planning. Therefore, consult a qualified CFP professional who specializes in philanthropic tax planning before implementing this strategy.

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