When an RRSP beneficiary faces a tax liability

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Upon death, the fair market value of an RRSP or RRIF is included in the deceased's estate as taxable income, unless a qualified rollover to a surviving spouse/partner or to a financially dependent infirm child or grandchild is available.

The liability to pay the taxes generally falls on the deceased's estate (or legal representative). Many people don't realize, however, that the CRA can go after the beneficiary named on the RRSP or RRIF,[1] who's jointly liable, along with the deceased's estate, for the deemed income inclusion in the deceased's year of death. This issue came to light in a tax case (O'Callaghan v The Queen, 2016 TCC 169) in which a taxpayer found herself on the hook for taxes owing on her late brother's RRSP, of which she was the sole beneficiary, despite her having written a personal cheque for half the RRSP's value to the estate's executor, presumably to cover the taxes owing.

The facts

Siegfried Starzyk died on July 19, 2007. At that time, he had RRSPs with a total fair market value of approximately $274,000 and a resulting associated tax liability of around $98,000. His sister, Sylvia O'Callaghan, received the $274,000 from the RRSP issuer (with no withholding) and wrote a cheque for $135,000 to Bruno Starzyk, the deceased's brother, which she maintained "was to pay the tax liabilities of the estate of (her late brother)."

CRA reassessed O'Callaghan's tax bill to the tune of nearly $58,000, which was the balance of tax owing on the estate of Siegfried relating to the deemed disposition of the RRSPs on death. The issue was whether O'Callaghan was jointly and severally liable for tax liability of her deceased brother resulting from the deemed disposition of his RRSPs.

O'Callaghan's position

O'Callaghan argued she should not be liable since, upon death, the FMV of the RRSP was to be included in her deceased brother's income. She pointed out the deceased's estate was liable for any tax owing on the RRSP's benefit. She further argued the deceased's estate has the primary liability for any taxes owed in respect of the RRSPs and that the joint liability section of the *Income Tax Act* "only applies if the deceased's estate does not have sufficient assets to pay the liability arising out of the RRSPs. As the deceased's estate had sufficient assets to pay the tax owing on the RRSPs, CRA was not entitled to assess the appellant for the

[1] Note that in Quebec, unless dealing with an insurance policy, RRSP or RRIF plans pass via the will or on intestacy, not by beneficiary designation on the plan.

tax owing." She stated that "she made out the cheque to the order of Bruno for an amount of $135,000, which represented approximately half of the RRSPs [sic] benefit, on the assumption that he would be the legal representative of the estate and would have to pay the […] taxes."

The ruling

The judge ruled that O'Callaghan was indeed liable for the tax assessed against her as "she was the sole beneficiary of the RRSPs of the deceased." Because she received a benefit from the deceased's RRSPs, "she became jointly and severally liable with the deceased to pay the deceased's tax for the year of his death." The judge confirmed that the *Income Tax Act* ("the Act") does not impose any obligation on the CRA to attempt to collect an amount from the estate or from the legal representative of the estate before issuing an assessment. The purpose of the joint liability rule "is to effect collection of the tax owed by the deceased that is associated with the collapse of his RRSPs."

As for the $135,000 cheque remitted to Bruno in his personal capacity approximately eight months before he was appointed legal representative of the estate, the judge said it "cannot be considered in any way as a payment of tax, as the Act specifically requires that payments of any tax amounts owing be paid directly to the Receiver General."

As the judge concluded, "Before writing a $135,000 cheque to her brother, the appellant should have sought professional advice to obtain confirmation that the issuance of the cheque was appropriate in the circumstances."

Lessons

1. Nothing in the *Income Tax Act* requires the CRA to go after the deceased's estate first for the tax. While the CRA has a practice of only going after the beneficiary if the estate is insolvent, it has no legal requirement to do that.
2. Financial institutions acting as RRSP/RRIF issuers do not withhold and remit taxes on payment of the RRSP/RRIF proceeds on death, be it a payment to the estate or to a designated beneficiary (apart from where the annuitant was a non-resident or a non-resident is the recipient and withholding must occur on any post-death increase in value). Indeed, the RRSP issuer has no authority to withhold for taxes on RRSPs/RRIFs arising on death and consequently also has no authority other than to pay the full amount of the proceeds under the plan terms to the person entitled. In short, issuers simply do not withhold tax when paying out proceeds of RRSPs/RRIFs on the death of the annuitant, even though the proceeds may be paid to a beneficiary while the tax liability lands in the estate that didn't get the proceeds.
3. RRSP/RRIF beneficiaries should get professional tax advice before making a payment to the executor of an estate.

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