

# COMMENT

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## NEW RRIF RULES

One of the 2007 federal budget changes was to increase the maximum maturity age for registered pension plans (RPPs), deferred profit sharing plans (DPSPs) and registered retirement savings plans (RRSPs) from age 69 to age 71. This change restores the maximum maturity age that was originally reduced from age 71 to 69 in 1997.

This provision was part of the federal government's "tax back guarantee," which promised to take any savings from federal debt reduction and use the funds to expand personal income tax reductions. By extending the age when an annuitant must mature his or her RRSP, the federal government has said that it is foregoing tax revenue of about \$100 million in each of the next two fiscal years. It should be noted that this is really only a tax deferral because the government will eventually get its taxes after payments begin two years later.

The change in RRSP maturity age has some positive implications for many taxpayers.

It means that someone can contribute to an RRSP up until the year he or she turns age 71. In addition, someone could contribute to a spouse's RRSP (i.e., a spousal RRSP) up until the year the spouse turns age 71. Of course, this assumes that the individual continues to have earned income or has unused contribution room carried over from previous years.

In addition, it means that the RRSP need not mature until age 71, which will allow those individuals (if they

are financially able to do so) to defer the receipt of such income for another two years. By deferring income for an additional two years, the RRSP will have time to grow a little larger and therefore provide more value to the annuitant or his or her family. Note, however, that while the tax rules now permit maturity up until the age of 71, the specific contract may provide for an earlier maturity date. As such, the wording of existing RRSP contracts needs to be reviewed to determine if the extension to age 71 is available.

The deferral has another benefit in that the annuitant will have less income to report in the years in which he or she is aged 70 or 71. Less income could mean the avoidance, or the reduction, of several tax clawback provisions. The Old Age Security benefit is clawed back when the recipient's net income exceeds a certain threshold. Similarly, the age tax credit is reduced when the recipient's net income exceeds a different threshold.

Those individuals who have already matured their RRSP into a RRIF will be able to transfer their RRIF back into an RRSP up until the year they turn age 71. Once back in an RRSP, it becomes an unmaturing plan that does not have to pay out an income. The rules also contain a provision that deems the RRIF minimum amount for 2007 to be nil for those annuitants that attained age 69 or age 70 in 2006 and, similarly, the RRIF minimum for 2008 will be nil for those who turned 70 in 2007. This rule effectively allows an individual to remain in

his or her RRIF in 2007 and/or 2008 but suspend income payments rather than transferring the RRIF funds back into an RRSP and then “rematuring” the plan in the next year or two.

Individuals who turned age 69 in 2005 will turn age 71 in 2007 and while they could theoretically transfer their RRIF back into an RRSP, that RRSP would have to mature before the end of 2007. As noted above, planning for this group may involve suspending the RRIF minimum payments in 2007 and resuming the RRIF minimum payments in 2008.

The factors for the RRIF minimum payment (where the RRIF was created after 1992) continue unchanged as follows:

Age as at January 1 <sup>st</sup>	RRIF min Factor
71	.0738
72	.0748
73	.0759
74	.0771
75	.0785
76	.0799
77	.0815
78	.0833
79	.0853

Age as at January 1 <sup>st</sup>	RRIF min Factor
80	.0875
81	.0899
82	.0927
83	.0958
84	.0993
85	.1033
86	.1079
87	.1133
88	.1196
89	.1271
90	.1362
91	.1473
92	.1612
93	.1792
94 or older	.2000

It should be noted that while the Income Tax Act permits a registered annuity to be commuted and transferred back into an unmaturing RRSP, the specific contract will have to be reviewed to determine the annuitant’s rights to do so.

I/R 5401.06, 5401.07

## BENEFICIARY DESIGNATIONS

**B**eneficiary designations are a very important part of estate planning. This means that great care should be taken to ensure that the designations follow the estate plan and are kept up to date. If the beneficiary predeceases the life insured, the deceased beneficiary’s estate is not entitled to any portion of the life insurance proceeds that become payable when the life insured dies. In that case, the benefit would be paid to the life insured’s estate, assuming that the life insured was the policyowner and had not designated a contingent beneficiary.

Monies paid pursuant to a beneficiary designation pass outside of the estate of the deceased. This avoids probate fees on those funds and also can avoid the public disclosure required to probate an estate. This can be important as it achieves a level of privacy with respect to the value passed onto the beneficiary; the other parties to the estate do not necessarily have to know about the bequest. Note, however, that the application of provincial dependant support legislation may still result in public disclosure of this information.

If a minor child is named as beneficiary, the monies would generally have to be paid into court until a suitable trustee can be named. Such a trust would be subject to periodic scrutiny of the provincial public guardian. If a minor child is to be a beneficiary of a life insurance policy, consideration should be given to the use of an insurance trust to receive the benefit proceeds and to provide for management as per the deceased’s wishes.

Canadian companies that are beneficiaries of an insurance policy are entitled to a credit to their capital dividend account for income tax purposes. The credit is equal to the death benefit received (i.e., reduced by any policy loan repayments) less the corporation’s adjusted cost basis in the policy. It is important to note that the company only has to be the beneficiary and not necessarily the owner of the insurance policy.

Also note that if a corporation owns a policy and pays the premiums, an individual should not be named as the policy beneficiary. Doing so could result in taxable benefits being attributed to the insured person, with no

deduction to the corporation. In other words, double taxation could result.

Of equal importance to keeping beneficiary designations up to date is the use of contingent beneficiary designations. The contingent beneficiary will be entitled to the proceeds of the life insurance policy if the primary beneficiary is not alive to receive his/her entitlement. The use of a contingent beneficiary designation is one means to keep an estate plan current but should not be

assumed to be the only means. The estate plan may call for a variation to a distribution plan, which means that primary and contingent beneficiary designations both need to be changed.

Beneficiary designations are a simple estate planning tool that bear a complete and thorough review every time the estate plan is updated or an individual's circumstances change.

I/R 1200.00

## RISK MANAGEMENT

Everyone manages risk in nearly every daily activity. Consider the decisions involved in driving a car into a parking lot and picking a parking space. Is it better to drive into a spot and back out later or to back into a spot and then be able to drive out later? The driver could consult books, government literature, driving schools, spouses and friends but would probably end up with no firm consensus. The decision would probably be based on personal risk management.

The same analysis could be applied to why and how some insurance companies add extra ratings. If the applicant pursues any dangerous recreational activities, such as sky diving or deep sea scuba diving, then he or she has chosen to be exposed to a certain level of risk. The insurance company can choose to average this risk into its overall pool or may choose to charge an extra amount to better match the risk to the price charged. The decision to acquire insurance does not eliminate the risk, but it does provide a means of limiting the financial impact of death on the insured or the insured's family.

In this example, the applicant probably cannot change how the insurance company rates "dangerous"

activities, but can choose to minimize his or her personal risk by wearing the appropriate safety equipment, taking training courses, using instructors, etc. The purchase of life insurance does not eliminate the risk of death – death is inevitable for everyone. It does, however, provide the means to deal with the financial impact in a manner based on one's personal choices.

This same concept could also be applied to retirement planning. The risks involved in retirement planning could include some or all of the following: inflation, investment rates of return, types of investment, taxation, life expectancy and the survivor's own financial security. An individual can minimize most of these risks by undertaking the proper planning and beginning as early as possible. Over-saving could compensate for many of these risks but then the "costs" of over-saving might not be worth the impact on current living.

Understanding oneself and the way in which we each make personal decisions can lower potential risks that we face in nearly every daily activity.

I/R 8100.00

## PRINCIPAL RESIDENCE

Almost every Canadian knows that the gain realized on the sale of a principal residence is not included in income nor does it attract any income tax liability. But this statement is not without numerous caveats.

The principal residence exemption can be claimed on a city home, a cottage or any other property that constitutes a "residence." The definition of a principal residence is fairly broad and generally means any housing unit ordinarily inhabited by the taxpayer, his or

her spouse and his or her children. A particular taxpayer could own more than one property that would qualify as a principal residence at the same time. The taxpayer must choose, on a year-by-year basis, which property to designate as principal residence for that year.

The designation of a property as a principal residence does not have to take place until after the property is sold and the taxpayer is filing the income tax return for the year of the disposition. This can be helpful where an

individual has two or more properties, such as a house and cottage, that potentially qualify for the exemption.

In order to claim the exemption, a form should be submitted by the homeowner with his or her income tax return in the year of disposition. The form would identify the taxation years for which the homeowner intends to designate the property as the principal residence. While it is the Canada Revenue Agency's (CRA's) administrative practice to provide considerable leniency in respect of this requirement, it could be important for the taxpayer to file this form.

For example, if the homeowner owns two properties and sells one but does not file the appropriate form with the CRA, then he or she, by default, has elected that the property sold has been designated as principal residence for the years of ownership. This could be a very important planning point because the homeowner may actually have a much larger accrued capital gain on the property retained.

This can be especially true with some cottage properties. Consider the example of a middle-aged couple that buys a cottage while at the same time owning a city

home. Over time, the couple sells and then buys a new city home several times, always upgrading based on the prior home's increased value. This means that when it comes to estate planning and preparing for the liquidity needed to fund the income tax triggered by death, a principal residence exemption will be available for only a few years. While this may make some sense because tax was avoided throughout the taxpayers' lifetimes and any taxes realized because of death could be insured, it is important that the taxpayers make informed decisions.

The principal residence exemption should not be taken for granted. Planning should carefully consider whether to designate the most recently sold property as the principal residence when the taxpayer owns more than one property that would qualify – particularly if there is only a small gain on the most recently sold property. While there may be the opportunity to save tax in current dollars, one should consider the value of future tax savings that may accrue in respect of the sale of the second property that may still be held.

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