The RRIF estate transfer

For the vast majority of Canadians, a registered retirement savings plan (RRSP) is a preferred choice for accumulating retirement capital. The benefits of tax-deductible contributions and tax-deferred growth are compelling. However, for some high-net-worth individuals, continuing to contribute to, or even preserving, their RRSPs and registered retirement income funds (RRIF) may not be the best option for enhancing the value of their estate.

Taxation of RRSPs and RRIFs

Amounts withdrawn or payments received from RRSPs and RRIFs are fully taxable[i]. In the case of a RRIF, the *Income Tax Act* (Canada) (the “Act”) requires an annual minimum amount to be paid to the annuitant, although the individual may withdraw more than the minimum. The RRIF minimum is calculated based on annual percentages provided under the Act[ii]. The most common option for an individual is to withdraw the RRIF minimum amount each year. If the amount isn’t needed to fund personal expenses, then the remaining after-tax amount is invested.

At death, the fair market value (“FMV”) of the assets held within a RRSP/RRIF is taxable to the deceased annuitant and must be reported in their final tax return. A tax-deferred rollover is available if the RRSP/RRIF is transferred by beneficiary designation or via the estate to the RRSP, RRIF or eligible annuity of a spouse, common-law partner or financially dependent child or grandchild. In the case of a financial dependent child or grandchild, the value of the RRSP/RRIF can only be used to purchase a term certain annuity with a maximum term to age 18. In the case of a financially dependent child or grandchild who’s dependent because of a physical or mental impairment, a rollover is available where the registered assets are transferred to a RRSP, RRIF, an annuity, or a registered disability savings plan[iii]. An alternative for a RRIF, is naming a spouse as a successor annuitant of the RRIF. On the death of the annuitant, the RRIF continues with all payments received and taxable to the surviving spouse.

The RRIF estate transfer strategy

The RRIF estate transfer strategy involves the early withdrawal of all or a portion of the client’s registered assets over a particular number of years and depositing the after-tax proceeds into a tax-advantaged permanent life insurance policy. The strategy aims to provide insurance protection and enhance the client’s after-tax estate value by withdrawing funds from a tax-deferred plan on a taxable basis and repositioning the after-tax amounts into a life insurance policy. As noted, the entire RRSP or RRIF balance is generally taxable at death. In contrast, a permanent life insurance policy allows for the tax-advantaged growth of policy values, within certain legislative limits, while inside the policy. On death, the insurance proceeds are paid tax-free to a named beneficiary. Making taxable withdrawals from a tax-deferred plan, like a RRSP or RRIF, may appear counter-intuitive; however, if the client’s objective is to enhance their after-tax estate value, the RRIF estate transfer strategy is worth considering for certain high net-worth clients[iv].

In addition to enhancing estate values, the RRIF estate transfer strategy offers clients:

- Permanent life insurance protection
- Immediate estate enhancement and estate preservation

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Possible source of liquidity while alive if the policy has cash value[v]

Potential creditor protection, under certain conditions[vi]

Elimination of probate fees on the insurance proceeds using a named beneficiary other than the estate (not applicable in Quebec where there are no probate fees)

Compare the options

Let's look at an example. John and Jane are ages 60 and 58, respectively, with no children. John currently has $650,000 saved within his RRSP. Assuming John no longer contributes to his RRSP and it grows at 3.5% per year. By the end of the year John reaches age 71– when John converts his RRSP to a RRIF[vii] – the RRIF will have a balance of over $948,980. At age 72, John will have to take out his RRIF minimum of $50,000 and owe $25,000 of tax on this amount (at an assumed marginal tax rate of 50%). John doesn't need the RRIF income for funding his lifestyle and he'll invest the after-tax amount in a non-registered portfolio. Should John die after Jane at age 72, he would owe over $465,000 in tax on his RRIF balance and his estate would be left with $491,000 after-tax. Should John die after Jane at age 85, his total after-tax estate value would be $710,000.

Instead, if John were to begin withdrawals from his RRSP today and use the after-tax proceeds to purchase a Canada Life participating life insurance policy, with annual premiums paid for 15 years[viii], his net estate value would be approximately $1,245,000 at age 85 – an increase of $536,000 or 76% compared to the conventional RRIF net after-tax estate[ix].

Conventional thinking: Minimum RRIF at 71 – RRIF income not needed for consumption[x]

		Income		Income re-invested					
Age	Beginning of year RRIF balance	Gross income, beginning of year	After-tax income (assumes tax withheld)	After-tax beginning of year invested	After-tax end of year balance	End of year RRIF balance	Tax to be paid on RRIF balance on death	After-tax RRIF estate balance	Total after-tax estate value
72	982,195	50,106	25,053	25,053	25,492	930,335	465,167	465,167	490,659
73	962,896	50,238	25,119	50,611	51,496	910,900	455,450	455,450	506,946
74	942,782	50,373	25,186	76,683	78,025	890,646	445,323	445,323	523,347
75	921,818	50,500	25,250	103,274	105,082	869,551	434,776	434,776	539,857
85	637,487	51,509	25,754	399,348	406,337	606,488	303,244	303,244	709,581
90	470,633	51,723	25,861	569,299	579,262	433,573	216,786	216,786	796,048

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Canada Life's RRIF estate transfer strategy[xi]

Age	Beginning of year RRSP or RRIF balance	Gross withdrawal beginning of year	After-tax withdrawal	End of year RRSP or RRIF balance	Tax paid on RRSP or RRIF balance on death	After-tax RRSP or RRIF estate balance	Annual Life insurance premium*	Life insurance death benefit*	Total estate value*
61	$650,000[xii]	$54,528	$27,264	$616,314	$308,157	$308,157	$27,264	$1,239,672	$1,547,829
62	$616,314	$54,528	$27,264	$581,448	$290,724	$290,724	$27,264	$1,241,792	$1,532,516
63	$581,448	$54,528	$27,264	$545,363	$272,681	$272,681	$27,264	$1,244,575	$1,517,256
64	$545,363	$54,528	$27,264	$508,014	$254,007	$254,007	$27,264	$1,248,053	$1,502,059
65	$508,014	$54,528	$27,264	$469,358	$234,679	$234,679	$27,264	$1,253,324	$1,488,002
66	$469,358	$54,528	$27,264	$429,350	$214,675	$214,675	$27,264	$1,260,397	$1,475,071
70	$300,722	$54,528	$27,264	$254,811	$127,406	$127,406	$27,264	$1,307,481	$1,434,887
75[xiii]	$54,528	$54,528	$27,264	$0	$0	$0	$27,264	$1,365,023	$1,365,021
85	$0	$0	$0	$0	$0	$0	$0	$1,245,444	$1,245,444
90	$0	$0	$0	$0	$0	$0	$0	$1,253,541	$1,253,541

*The above example is for illustrative purposes only. Situations will vary according to specific circumstances.

The dividend scale interest rate is the interest rate used in determining the investment component of the dividend scale. It is only one factor that contributes to an individual policy's performance. The actual cash value growth in any policy varies, based on a number of factors, such as type of product, product features, premium-paying period, issue age, rating, dividend option, the dividend scale and others. Performance data is provided for illustrative purposes only and represents past performance, which is not necessarily indicative of future performance.

Who should look more closely at this strategy?

High-net-worth Individuals with sufficient net worth and projected retirement income, who will not require all of their registered income in retirement, may want to consider the merits of repositioning a portion or all of their after-tax RRSP capital onto a tax-advantaged permanent life insurance policy.

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[i] Subsections 146(8) and 146.3(5) of the Act.
[ii] Regulation 7308 of the Act.
[iii] Subject to certain conditions.
[iv] This strategy should only be utilized for clients who have other sources of cash flow to fund their retirement and understand that a surrender (partial or full) and policy loans on a life insurance policy may be a taxable disposition that results in taxable income (policy gain).
[v] Accessing cash value of a life insurance policy (i.e. surrender or policy loan) may trigger a taxable policy gain.
[vi] Creditor protection depends on court decisions and applicable legislation, which can be subject to change and can vary from each province; it can never be guaranteed. Talk to your lawyer to find out more about the potential for creditor protection for your specific situation.
[vii] Rather than purchasing an annuity.
[viii] Premium offset is illustrated to occur in year 16, based on the 2020 dividend scale rates, dividends are not guaranteed, therefore the premium offset date is not guaranteed.
[ix] Canada Life Estate participating life insurance pay to age 100, male age 60 and female age 58, non-smoker, standard risk, joint-last-to-die, $894,220 basic overage, $27,264 annual premium, paid-up addition dividend option, premiums payable to last death, premium offset from year 16, 2020 dividend scale.

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[x] Rate of return on RRIF and non-registered re-investment rate of return is 3.5%, investment allocation is interest, marginal personal tax rate 50%.
[xi] Rate of return on RRIF is 3.5%, investment allocation is interest, marginal personal tax rate 50%.
[xii] There is risk that the FMV of the RRIF will not be sufficient to cover the full premium on the life insurance policy. The client should ensure they have other means to cover any shortages.
[xiii] At this age, the RRIF is fully depleted, which corresponds with the last life insurance policy premium prior to going on premium offset.

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