RBC Wealth Management

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Income taxes at death

The two certainties of life collide

Coping with the death of someone you care about is stressful enough. The legal, financial and tax considerations at this time only add to this stress. This article contains information that may assist a deceased's legal representative and the family in settling the deceased's tax affairs.

This article outlines strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax and/or legal advisor before acting on any of the information in this article.

Please contact us for more information about the topics discussed in this article.

Responsibilities of the legal representative

You are likely the legal representative for the deceased person if you are named as the executor in their Will, you are appointed as the administrator of their estate by a court, or you are the liquidator for their estate in Quebec.

As the legal representative, you have a number of responsibilities and duties. As part of these administrative duties, you should advise government authorities (such as the Canada Revenue Agency (CRA) and Service Canada) as soon as possible of the date of death of the individual. You should also notify financial institutions, employers and anyone else with whom the deceased had business or financial relationships.

Under the Income Tax Act, you are responsible for filing all required tax returns for the deceased and making sure all taxes owing are paid. You must also let the beneficiaries know which of the amounts they receive from the estate are taxable and which are not.

You may also be required to file a T3 Trust Income Tax and Information Return for income the estate earns after the date of death or if the terms of the Will create a testamentary trust or trusts. However, you may not have to file a T3 return if the estate is distributed immediately after the individual dies or if the estate did not earn income before the final distribution. In these cases, it may be sufficient to provide each beneficiary with a statement showing their share of the estate.

You may consider getting a clearance certificate before you distribute any property under your control to certify that all amounts owing to the CRA are

If you do not get a clearance certificate, you can be liable for any amount the deceased owes to the CRA.

paid. A clearance certificate certifies that all of the deceased's tax returns are up-to-date and all taxes have been paid or that security has been provided to the CRA for the payment of taxes. If you do not get a clearance certificate, you can be liable for any amount the deceased owes to the CRA. If the deceased or the estate owes taxes to other tax jurisdictions, such as the U.S. Internal Revenue Service (IRS), you may want to obtain a similar certificate, if possible, before making a distribution from the estate.

Instalments

No instalments have to be paid for a deceased person for the period after the date of death. However, you should ensure that any instalments due prior to the date of death were paid; if not, they should be paid as soon as possible.

Income tax returns

The deceased's income from January 1 of the year of death up to and including the date of death must be reported on a final income tax return. If any income is earned after the date of death, it should be reported on a T3 Trust Income Tax and Information Return instead of the deceased's final return. You must also file tax returns for any prior years for which the deceased had not filed a tax return.

For the year of death, you may be able to elect to file more than one return for certain types of income. These are referred to as optional returns and are discussed in our separate article, "Optional Returns for a Deceased Individual". You may be able to reduce or even eliminate income taxes on the deceased's income by filing more than one return.

Due dates for filing tax returns

The deadlines for filing returns may vary depending on whether it's a final return, an optional return, or a return for a year prior to death.

A. Final return

In general, the filing due date for the final return is the same as for all individual income tax returns (April 30 of the following year or June 15 for taxpayers carrying on a business), or six months after the date of death, whichever date is later. For example, if a person dies on December 20, you have until June 20 of the following year to file the final return. On the other hand, if the taxpayer died on May 10, the filing deadline would be April 30 of the following year.

Death Occurred	Due Date for the Final Return
January 1 – October 31	April 30 of the following year
November 1 – December 31	Six months after the date of death

The deceased is deemed to have disposed of all of their capital property immediately before death.

The due date for filing the T1 return of a surviving spouse or common-law partner who was living with the deceased is the same as the due date for filing the deceased's final return. However, any balance owing on the surviving spouse or common-law partner's return still has to be paid on or before April 30 of the following year to avoid interest charges.

B. Previous year return

A person may die after December 31, but on or before the filing due date for his or her T1 return for the immediately preceding year (usually April 30). In such a case, if that person has not yet filed that return, the due date for filing that return, as well as for paying the balance owing, is six months after the date of death. The due date for filing the prior year T1 return of a surviving spouse or common-law partner who was living with the deceased is the same as the due date for filing the deceased's prior year return. However, any balance owing on the surviving spouse's or common-law partner's return still has to be paid on or before April 30 of the current year to avoid interest charges. The filing due dates for prior year returns that are already due but which the deceased had not yet filed, remain the same.

The deceased's Will or a court order may set up a testamentary spousal or common-law partner trust. When testamentary debts of the deceased or the estate are being handled through the trust, the due date for the final return is extended to 18 months after the date of death.

Due date for balance owing

Taxes must be paid no later than the filing due date for the returns, unless the filing date is June 15 (for taxpayers carrying on a business), in which case the payment date will be April 30. If a return is filed late, a late-filing penalty and interest are charged.

Determining the deceased's income for the terminal tax return

The deceased's income from January 1 of the year of death up to and including the date of death must be reported on the final income tax return. This includes all periodic amounts earned prior to death—such as salary, interest, rent and most annuities—even if the deceased did not receive them before they died. These amounts must be payable prior to death to be includable on the deceased's final return.

In addition, the deceased is deemed to have disposed of all of their capital property immediately before death.

Deemed disposition of capital property

In general, a deceased person is deemed to dispose of all of their capital property at fair market value (FMV) immediately before death. Even though there was not an actual sale, the deemed disposition may result in a capital gain or, except for personal-use property, a capital loss. (We do not deal with the deemed disposition of depreciable capital property in this article.) The resulting capital gain or loss is included in the deceased's final tax return.

There is an exception to this rule for capital property left to a spouse or common-law partner or a qualifying spousal trust. In this case, the property is deemed to rollover to the spouse or common-law partner or spousal trust at the deceased's adjusted cost base and any capital gain or loss is deferred until the property is disposed of (or is deemed to be disposed of) by the spouse or common- law partner or the spousal trust. However, the legal representative can elect to transfer the deceased's capital property to a surviving spouse or common-law partner or spousal trust at FMV rather than at the deceased's adjusted

You can report some types of investment income as “rights or things” on a separate optional return.

cost base. You may wish to do so if the deceased owned shares in a qualified small business corporation or qualified farm or fishing property, or where the deceased has unutilized capital losses at the date of death. This election must be made when you file the final tax return for the deceased.

Investment income

Report all investment income the deceased received from January 1 to the date of death. This type of income includes dividends and interest. Also include the following:

- amounts earned from January 1 to the date of death that have not been paid;
- amounts earned from term deposits, guaranteed investment certificates (GICs), and other similar investments from the last time these amounts were paid to the date of death;
- bond interest earned from the last time it was paid to the date of death, if the deceased did not report it in a previous year; and
- compound bond interest that accumulated to the date of death, if the deceased did not report it in a previous year.

You can report some types of investment income as “rights or things” on a separate optional return. For more details on the “rights or things” optional return see our article “Optional Returns for a Deceased Individual”.

RRSP/RRIF income

Generally, a deceased annuitant is deemed to have received, immediately before death, an amount equal to the FMV of all the property of the RRSP/RRIF plan at the time of death. You have to include this amount in the deceased’s income for the year of death. There are a few exceptions to this rule which are discussed in a separate article, “Estate Planning for Your RRSP/RRIF.”

Sometimes, the FMV of the property of an RRSP/RRIF can decrease between the date of death and the date of final distribution to the beneficiary or the estate. If the total of all distributions from the RRSP/RRIF is less than the FMV of the property that was included in the deceased annuitant’s income for the year of death, the deceased’s legal representative can request that the difference between the FMV and the total of all distributions be deducted on the deceased’s final return. Generally, for the deduction to be allowed, the final distribution must occur by the end of the year that follows the year of death.

Death benefits (other than Canada or Quebec Pension Plan death benefits)

A death benefit is an amount received after a person’s death for their employment service. A death benefit payable in respect of the deceased person is not reported on the final return for the deceased; rather, it is considered to be income of the estate or the beneficiary that receives it. Up to $10,000 of the total of all death benefits paid may not be taxable. Any amount of death benefits above $10,000 would be taxable to the beneficiary or estate that receives it.

RRSP deduction

No one can contribute to a deceased person’s RRSPs after the date of death. However, if the deceased individual has RRSP contribution room at the time of death, as legal representative, you can make contributions to a spousal RRSP for the surviving spouse or common-law partner in the year of death or during the first 60 days after the end of that year. These contributions can be claimed on the deceased individual’s final return up to the deceased’s RRSP deduction limit for the year of death.

Pension income splitting

It may still be possible to split pension

As of January 1, 2016, donations made by Will or by designation under a RRSP, RRIF, TFSA or life insurance policy will no longer be deemed to be made by an individual immediately before death.

income included on the deceased's final return. To make this election, as the deceased's legal representative, you and the deceased's spouse or common-law partner must jointly elect to split pension income by completing Form T1032, Joint Election to Split Pension Income. Form T1032 must be filed by the filing due date for the deceased's final return.

Funeral and estate administration expenses

Funeral and estate administration expenses are personal expenses and are not deductible in calculating the income of the deceased or the estate.

Personal non-refundable tax credits

If the deceased was a resident of Canada from January 1 of the year of death to the date of death, you can claim the full personal amounts on the deceased's final tax return. If the deceased was a resident of Canada for only part of the time from January 1 of the year of death to the date of death, you may have to prorate the personal amounts.

Medical expenses

Medical expenses paid by the deceased or their spouse or common-law partner for either of them or their dependent children under 18 for any 24 month period that includes the deceased's date of death may be claimed on the deceased's terminal tax return. To claim medical expenses for 24 months in the year of death, the tax return of a prior year could be adjusted so that no medical expense is claimed in that year, leaving the expense available for the year of death.

Donations

Prior to 2016, charitable donations made in a Will were generally deemed to be made by the individual immediately before death and were claimed on the deceased's final tax return; any excess amount that could not be claim in the year of death could be claimed on the immediately preceding year's tax return. Charitable donations could not be carried forward from the deceased individual to be claimed by their estate.

As of January 1, 2016 (for deaths occurring after 2015), donations made by Will or by designation under a RRSP, RRIF, TFSA or life insurance policy will no longer be deemed to be made by an individual immediately before death. Instead, the donations will be deemed to be made by the estate at the time the donation is made to a qualified donee. The estate can claim a donation in the year a gift is made or in the five subsequent years.

If the donation is made by a "graduated rate estate" (GRE), the trustee of the estate will have the flexibility to allocate the available donation among:

- The taxation year of the GRE in which the donation is made;
- An earlier taxation year of the GRE;
- The GRE's tax return for the five years following the year the GRE made the donation; or
- The last two taxation years of the deceased individual.

Note that this flexibility does not extend to a testamentary spousal trust and is only applicable to a GRE. Generally, a GRE of an individual is the estate that arose on and as a consequence of the individual's death for the first 36 months after death. To be considered a GRE, the estate also needs to remain a testamentary trust and be designated for its first taxation year as the individual's GRE. A GRE is discussed in more detail in our article, "Testamentary Trusts."

Under the current rules, a donation must be made by the GRE within 36 months of an individual's death to be eligible for the flexible donation rules just discussed. However, on January 15, 2016, the Department of Finance released draft legislative

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proposals, for consultation, which proposes changes to these rules. It proposes that, if an estate makes the donation after 36 months, but before 60 months, after the taxpayer's death and continues to meet the other requirements of a GRE, other than the 36 month time period, then it will still qualify for some flexibility in claiming the donation. In this case, the donation can be claimed:

- By the estate in the taxation year in which the donation is made;
- By the estate in the five years following the year the donation is made; or
- By the deceased individual in their last two taxation years (terminal return and the immediately preceding year).

Under the proposals, where the donation is made in the period between 36 months and 60 months after the taxpayer's death, the donation cannot be claimed by the estate in the taxation years before the year the donation is made.

The draft legislation also proposes that for donations of qualifying securities, ecological or cultural property, that a 0% capital gain inclusion rate will apply for donations made by a deceased's estate if the donation is made within 60 months of the individual's death and the estate continues to meet the other requirements of a GRE, other than the 36 month time period. The proposals apply to 2016 and subsequent taxation years.

If a donation is claimed on the estate's return, the maximum charitable donation that can be claimed is 75% of net income of the estate. If the donation is claimed on the deceased's final return or the tax return for the year before the year of death then the maximum charitable donation that can be claimed is 100% of net income.

Alternative minimum tax (AMT)

AMT limits the tax advantage a person can receive in a year from certain tax incentives (e.g. tax deductions from flow-through shares). AMT does not apply to a person for the year of death. However, the deceased may have paid AMT in one or more of the seven years before the year of death. If this is the case, you may be able to deduct part or all of the AMT the deceased paid in those years from the tax owing for the year of death.

Net capital losses

If the deceased had unused capital losses at death, there may be an opportunity to deduct these unused capital losses from any type of taxable income in the year of death or preceding year after certain adjustments. Typically capital losses can only offset capital gains for tax purposes; however, there is an exception to this rule for deceased taxpayers.

Generally, when allowable capital losses are more than taxable capital gains, the difference is a "net capital loss". Currently, the inclusion rate is one-half. Therefore, an allowable capital loss is one-half of a capital loss and a taxable capital gain is one-half of a capital gain.

Net capital losses in the year of death

If a net capital loss occurs in the year of death, there are two methods for claiming this loss.

The first method is to carry back the net capital loss from the year of death to reduce any taxable capital gains in any of the three tax years before the year of death. The loss you carry back cannot be more than the taxable capital gains in those years. To request a loss carryback, complete and file Form T1A, Request for Loss Carryback. Do not file an amended return for the year to which you want to apply the loss.

As the legal representative, you should determine if the deceased has a U.S. estate tax liability.

After you carry back the loss, there may be an amount remaining. You may be able to use some or all of the unutilized net capital loss to reduce any other income on the deceased's final return, the return for the year before the year of death, or both returns. To determine the amount of the unutilized net capital loss that may be claimed, you must first subtract any capital gains deductions the deceased has claimed to date. The loss that remains may be used to reduce any other income for the year of death, the year before the year of death, or both years.

With the second method, you can choose not to carry back the net capital loss to reduce taxable capital gains from earlier years. You may prefer to reduce any other income on the final return, the return for the year before the year of death, or both returns. However, before you do this, you have to calculate the amount you can claim. You must subtract any capital gains deductions the deceased has claimed to date from the net capital loss. Any loss remaining can be used to reduce any other income for the year of death, the year before the year of death, or both years.

If you claim any remaining net capital loss in the year before the year of death, you will need to complete Form T1-ADJ, T1 Adjustment Request, or send a signed letter providing the details of your request. Send your Form T1-ADJ or letter separately from the deceased's final return. Applying net capital loss to a previous year may reduce any capital gains deductions the deceased claimed in that year or a following year.

Net capital losses before the year of death

The deceased may have incurred a net capital loss before the year of death but never applied it. If so, you can apply the loss against taxable capital gains on the final return. If there is still an amount remaining, you may be able to use it to reduce any other income on the deceased's final return, the return for the year before the year of death, or both returns. You cannot use the net capital losses of other years to create a negative taxable income for any year. As these special rules on the deductibility of capital losses for deceased persons are quite complex, consult your qualified tax advisor for further details.

Net capital loss in the first year of the estate

As the legal representative, you are responsible for administering the deceased's estate. If you dispose of capital property in the administration of the estate, the result may be a net capital loss. Usually, you would claim these losses on the estate/trust's T3 Trust Income Tax and Information Return. However, if the allowable capital losses exceed the taxable capital gains realized by the deceased's estate in its first tax year, you can choose to claim all or part of these losses on the deceased's final return. Any net capital loss realized after the date of death but in the first year of the estate can only be applied to the year of death (and not to the year before the year of death) or carried forward if the estate continues.

U.S. estate tax

As the legal representative, you should determine if the deceased has a U.S. estate tax liability. There are penalties under the U.S. Internal Revenue Code should a legal representative knowingly avoid filing a U.S. estate tax return. You are required to file a U.S. estate tax return for a deceased Canadian if they held at least US $60,000 of U.S. situs assets at the time of their death even if there if no U.S. estate tax liability. Refer to our article "U.S. Estate Tax for Canadians" for more information on U.S. estate tax.

If U.S. estate tax was paid to the IRS, then in certain circumstances

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it may be possible to claim a foreign tax credit on the deceased's final Canadian income tax return for the U.S. estate taxes paid to minimize double taxation.

Conclusion

Filing tax returns for a deceased person and determining whether any post-mortem tax planning will save taxes can be complicated. It is advisable to seek assistance from a qualified tax and/or legal advisor in this situation.

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