Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Weatherill Wealth
of RBC Dominion Securities
4900 - 50th Street, Suite 300
Red Deer, AB T4N 1X7
www.bradweatherill.ca

Brad Weatherill, CIM
Senior Wealth Advisor
Tel: 403-341-8868
brad.weatherill@rbc.com

Sue Senio
Associate Wealth & Investment Advisor
Tel: 403-341-7400
susan.senio@rbc.com

Trent Nicolay, CFP, BComm
Associate Wealth Advisor
Tel: 403-341-8872
trent.nicolay@rbc.com

Nathan Dyck, BBA
Associate
Tel: 403-341-7225
nathan.dyck@rbc.com

Shauna Gaume
Client Experience Associate
Tel: 403-341-8854
shauna.gaume@rbc.com

Theron Gustafson, BComm
Administrative Assistant
Tel: 403-340-7303
theron.gustafson@gmail.com

# The financial impacts of losing a spouse

**Having your spouse pass away is a difficult and likely overwhelming experience, and coping with the emotional aspects is just one step in a long journey. There are also many financial issues that will be important for you to address. Managing your finances can be challenging even at the best of times, however, it's often the decisions you make, or don't make, during transitional periods in your life that will have the most impact on your overall financial picture. It's never too early or too late to plan for your financial future.**

**For the purposes of this article, any reference to a spouse includes a person who is considered to be a common-law partner under the Income Tax Act and/or the relevant pension legislation.**

## Organize your financial affairs

Organizing your financial affairs would be a good first step to take. This involves finding out exactly what assets you and your spouse owned and what liabilities the two of you may have had. By knowing your financial position, you can gain some insight into your net worth.

### Identify your sources of income

You can start organizing your financial affairs by identifying your sources of income. Knowing your income sources makes it easier to begin managing your finances. Sources of income can include employment income, income from investments, and income from retirement vehicles like a registered pension plan (RPP), registered retirement savings plan (RRSP) or registered retirement income fund (RRIF).

### Establish your own credit

It's important to establish your own credit record so that you will have the ability to get credit if needed. If you've never had a credit card in your own name, consider applying for one. You should also contemplate getting a line of credit in case you have a temporary need for cash while your spouse's financial affairs are being settled. The interest charges associated with a line of credit are generally much lower than credit card interest rates. In addition, you should notify all other known creditors (such as your mortgage representative or bank loan officer) of your change in marital status.

### Gather relevant documents

Gathering relevant documents may prove to be helpful to you or your professional advisors that are helping you get or keep your financial life on track. These documents include:

- Birth and marriage certificates
- Will and power of attorney (POA) documents
- Title deeds to your home and any other real property you own
- Most recent mortgage statement
- Ownership records for your motor vehicles
- Current bank account statements
- Investment account statements
- Tax returns for you and your spouse for the past three to five years or longer, if possible
- Business tax returns
- Business financial statements
- Shareholder/partnership agreements
- Stock option plan statements
- Company pension plan statements
- Retirement account statements such as from your RRSP or RRIF
- Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) information statements
- Current credit card statements
- Current statements of all other outstanding loans
- Promissory notes or evidence of family loans
- Trust deeds
- All insurance policies (such as home, auto and life)

## Understand the financial impact

### Income tax treatment of common estate assets

It's important to understand the income tax treatment of common estate assets, such as capital property, an RRSP or RRIF, and a tax-free savings account (TFSA) on your spouse's death. Knowing the tax implications will help you understand the impact on your future income stream as well as enhance effective planning for these assets.

#### Capital property

In general, a deceased person is deemed to dispose of their capital property (e.g. a rental property, shares of a holding company, a securities portfolio) at fair market value (FMV) immediately before their death. Although there was not an actual sale, the deemed disposition may result in a capital gain or, except for personal-use property, a capital loss. The resulting capital gain or loss is included in the deceased's final tax return.

When an individual dies and has an RRSP or RRIF, they are generally deemed to have received immediately before their death an amount equal to the FMV of all the property of the RRSP or RRIF at the time of death. This amount is included as income in their final tax return.

There is an exception to the deemed disposition rule for capital property left to a spouse or a qualifying spousal trust. In this case, the property is deemed to roll over to the spouse or spousal trust at the deceased's adjusted cost base (ACB), 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 spousal trust.

As such, if you inherited any capital property from your deceased spouse, the taxes on any capital gains that have accrued on these assets when they were owned by your spouse will generally be deferred until you dispose of these assets or pass away. You should note, however, that it is possible for your deceased spouse's legal representative (executor under the Will or court appointed administrator if no Will) to elect to transfer capital property, on a property-by-property basis, to you (or a spousal trust) at FMV rather than at your deceased spouse's ACB. This may make sense if your deceased spouse had low income for the year of death or unutilized capital losses at the date of death. They may also wish to do so if your deceased spouse owned shares in a qualified small business corporation or qualified farm or fishing property and it makes sense to utilize your deceased spouse's lifetime capital gains exemption.

#### RRSP and RRIF

When an individual dies and has an RRSP or RRIF, they are generally deemed to have received immediately before their death an amount equal to the FMV of all the property of the RRSP or RRIF at the time of death. This amount is included as income in their final tax return.

There are certain exceptions to this rule. For example, if you, a surviving spouse, are named as the beneficiary of the deceased's RRSP or RRIF, and transfer the RRSP or RRIF proceeds into your own RRSP or RRIF, or use the proceeds to purchase an eligible annuity, the taxes on the value of your deceased spouse's RRSP or RRIF can be deferred until the proceeds are withdrawn from your RRSP or RRIF, until payments are received from the annuity or until you pass away.

If your deceased spouse had a RRIF and named you as successor annuitant, the taxes on the RRIF proceeds can

also be deferred. The RRIF continues to exist after your spouse's death and you become the annuitant of the plan. All payments made out of the RRIF following your spouse's death are taxed in your hands. If the RRIF minimum payments were based on your deceased spouse's age, and you are younger, you are able to collapse the RRIF and open a new one with payments based on your age. This will reduce the minimum payment you are required to receive each year.

If you are not named as beneficiary or successor annuitant of your deceased spouse's RRSP or RRIF on the plan documentation, it may still be possible to defer the tax on your deceased spouse's RRSP or RRIF proceeds. If you are beneficially entitled to the RRSP or RRIF proceeds under the terms of your deceased spouse's Will or, if there is no Will, the provincial or territorial intestacy laws, you may be able to defer the tax by transferring the deceased's RRSP or RRIF proceeds to your own RRSP or RRIF or using them to purchase an eligible annuity. It may also be possible to be appointed as successor annuitant of their RRIF. The legal representative of your deceased spouse's estate will need to consent to this designation and your financial institution will also need to agree.

The benefit of these tax deferral strategies is that the value of your deceased spouse's RRSP or RRIF can be included in your taxable income over time, at a potentially lower tax rate than if it was taxed all at once in your deceased spouse's terminal tax return. The proceeds can also continue to benefit from tax-deferred growth. It's important to note, however, that if you are named as beneficiary of your spouse's RRSP or RRIF, there's no requirement to transfer the proceeds into your own RRSP or RRIF or use the proceeds to purchase an eligible annuity and defer the tax. In fact, there may be situations where it may make sense for you, as a beneficiary of your deceased spouse's RRSP or RRIF to not engage in a tax deferral strategy and receive the RRSP or RRIF proceeds outright. This may be appropriate where you have an immediate need for cash or do not need future retirement savings. It may also make sense if your deceased spouse has minimal income in the year of death or has unused losses carried forward from prior years. This is something that you and the legal representative of your deceased spouse's estate may wish to discuss with a qualified tax advisor.

### TFSA

During a TFSA holder's lifetime, any income and capital gains earned on the amounts contributed to a TFSA accumulate tax-free. Withdrawals from a TFSA are also tax-free. On a TFSA holder's death, their TFSA will generally need to be collapsed. The FMV of the plan at the date of death can be paid out to a named beneficiary or the deceased's estate, if there is no named beneficiary, free of tax. By contrast, the income and capital gains that accrue following the death of the TFSA holder are generally taxable.

During a TFSA holder's lifetime, any income and capital gains earned on the amounts contributed to a TFSA accumulate tax-free. Withdrawals from a TFSA are also tax-free. On a TFSA holder's death, their TFSA will generally need to be collapsed.

If you are named as the successor holder of your deceased spouse's TFSA, their TFSA will not have to be collapsed on their death. Instead, you will step into their shoes and take over their TFSA. This ensures that any income and capital gains that accrue in the TFSA after the date of death is sheltered from tax. Being named as successor holder does not affect your unused TFSA contribution room—if you already have your own TFSA prior to your spouse's death, you would be considered the holder of two separate TFSA accounts following your spouse's death.

If you are not designated as a successor holder of your deceased spouse's TFSA, but as beneficiary, you will be subject to tax on any income earned after the date of death in the TFSA. However, you may be able to transfer a payment received from your deceased spouse's TFSA to your own TFSA without affecting your unused TFSA contribution room, subject to certain conditions and limits. In particular, the amount transferred cannot exceed the FMV of your deceased spouse's TFSA at the time of their death.

## Government pension plans

### CPP/QPP

If your deceased spouse contributed to the CPP or QPP, you may be entitled to a lump-sum death benefit of $2,500 and a survivor's pension.

As the survivor, you are responsible for applying for the monthly survivor's pension. You should apply as soon as possible after your spouse's death. Once the application to receive a survivor's pension has been processed, the earliest you can start receiving the CPP or QPP survivor's pension is the month after your spouse's death. If you delay applying, you may lose benefits since the CPP and QPP can only make back payments for up to 12 months.

The amount of a CPP survivor's pension will depend on:

- whether your deceased spouse was under or over age 65 at the time of death;
- whether you are under or over age 65 at the time of your spouse's death; and
- how much, and for how long, your deceased spouse contributed to the CPP.

The amount of a QPP survivor's pension will depend on:

- your deceased spouse's contributions to the QPP;
- your deceased spouse's retirement supplement, if they were receiving one;
- your age;
- whether you support dependent children of your deceased spouse;
- whether you are disabled; and
- whether you are already receiving a retirement or disability pension.

If you already receive a CPP or QPP retirement pension, the survivor's pension will be combined into a single monthly payment. There is a maximum amount, determined by law that can be paid to a person where they are eligible for both a CPP or QPP retirement pension and a survivor's pension. The combined benefit is not necessarily the sum of the two separate benefits.

You may wish to contact Service Canada or Retraite Québec for more information on the survivor benefits. Also, be sure to officially notify them of your spouse's death, so neither makes any overpayments that will need to be repaid later.

## Employer retirement plans

### RPP

If your spouse had an RPP with their employer, you may be entitled to a lump-sum or monthly payment from the company pension plan. There are two types of RPPs, defined benefit (DB) and defined contribution (DC). The benefits you may be entitled to depend on which type of plan your deceased spouse had. You should contact any former employers of your spouse to see whether your spouse had any pension plans or other benefits to which you may be entitled.

If your spouse had an RPP with their employer, you may be entitled to a lump-sum or monthly payment from the company pension plan.

**Spouse's death before receipt of pension (for DC or DB plans)**

If your deceased spouse's pension was fully vested upon death, you, as the surviving spouse, may have the option to receive a fixed pension from the employer or to receive a lump-sum commuted value that may or may not be locked-in, depending on the applicable jurisdiction. You may be able to transfer the lump-sum payment on a tax-deferred basis to an RRSP, RRIF, locked-in plan or life annuity. Any pension payments or lump-sum amounts that are not transferred to a tax-deferred vehicle and are paid out in cash will be taxable to you in the year you receive the payment.

**Spouse's death after receipt of pension (for DB plans)**

If your spouse had been receiving a benefit from their DB pension plan, then in general, there would be a minimum survivor pension that you, as the surviving spouse, must receive unless you have waived your entitlement to the pension. A surviving spouse is generally entitled to receive a pension that is at least 60% of the monthly pension that the pension plan member was receiving immediately before their death. However, in some cases it is possible for the surviving spouse to receive a pension that is greater than 60%.

Your spouse may have also chosen a guarantee period upon retirement to ensure that in the event of an early death, their survivors receive 100% of their annual pension until the end of the guarantee period. If your spouse chose this option on retirement, and passed away during the guarantee period, you may continue to receive 100% of their pension until the end of the guarantee period. After the guarantee period has elapsed, you will continue to receive a survivor pension.

You, as the surviving spouse, will be subject to tax on any payments received.

**Member's death after receipt of pension (for DC plans)**

If your deceased spouse had already retired and was receiving an income from the DC plan at the time of their death, then, unless you have waived your right to the pension, you will generally be able to select any benefit option that's available to a plan member. These options may include keeping the funds in the DC plan, transferring the funds to an RRSP or RRIF or locked-in retirement plan, or using the funds to purchase an annuity. Any payments or lump-sum amounts that are not transferred to a tax-deferred vehicle and are paid out in cash will be taxable to you in the year you receive the payment.

**Deferred profit sharing plan (DPSP)**

A DPSP is a type of tax-sheltered retirement plan that is set up by an employer for the benefit of its employees, subject

to certain restrictions. Income and capital gains earned within a DPSP grow tax deferred, similar to an RRSP.

In general, an employee is fully vested in the plan after 24 consecutive months of plan membership. Once vested, it may be possible to withdraw funds from the DPSP; however, an employer can impose restrictions on withdrawals.

If your spouse passed away having vested funds in a DPSP, these funds must be paid out to their designated beneficiary or their estate, if there is no named beneficiary, within a certain time period after their death. Payments from a DPSP are taxable to the named beneficiary or the estate in the year the payment is received. However, if you are designated as the beneficiary of your spouse's DPSP, you can roll over the payment on a tax-deferred basis to your own RRSP, RRIF, DPSP or RPP. This rollover has no impact on your unused RRSP contribution room.

## Review your estate and incapacity planning

Determining how your assets are owned (i.e. in sole name, joint name, by a corporation or trust) is important to understanding your rights to the property during your lifetime. It's also key to creating a good estate plan and ensuring your assets pass in accordance with your intentions on death.

After your spouse's death, you may wish to review the following:

- ownership of your assets;
- your Will(s);
- POA for financial affairs;
- health care decision maker (POA or representative);
- beneficiary designations on your TFSA, RRSP/RRIF, RPP and life insurance.

You will want to ensure your Will(s) and POAs, beneficiary designations and any other documents are up to date and changes related to your spouse's death are addressed.

Determining how your assets are owned (i.e. in sole name, joint name, by a corporation or trust) is important to understanding your rights to the property during your lifetime.

## Preserve your assets

If your spouse passes away, you may be feeling more vulnerable. Take time to think over any financial proposals brought to you and discuss them with your trusted, qualified advisors.

If and when you're ready to enter into a new relationship, consider having your lawyer draw up a pre-nuptial agreement that will help protect you and your heirs.

## Conclusion

Losing a spouse can be emotionally devastating and the thought of tackling all of the ensuing financial implications may be overwhelming. Taking proactive measures to secure your financial well-being will only serve as a benefit to you in the future. To help you navigate through the financial implications of losing a spouse, you may want to reach out to your RBC advisor, as well as other qualified professional tax and legal advisors that you trust.

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