Andrea Agnoloni

Death and Taxes: Here to Stay

Early in the year, I attended the Executor Administration Course organized by The Society of Notaries Public of BC.

I was overwhelmed to learn the amount of work and responsibilities an executor must undertake to carry out the last wishes of the Will-maker.

As a Certified General Accountant, I am often engaged by clients who are acting as executors of an estate to help them comply with the reporting of income as a result of death and the computing of the final income tax bill.

There are a number of special rules to follow in connection with filing the tax return of deceased individuals and unless you are familiar with the rules, I recommend that you seek professional assistance.

- If an individual dies between January 1 and October 31, the final tax return is due April 30 of the year following the year of death.
- If the individual dies between November 1 and December 31, the return is due 6 months after the date of death.

The executor must ensure all the necessary returns are filed and the taxes owed are paid.

I was overwhelmed to learn the amount of work and responsibilities an executor must undertake…

- The executor must advise the beneficiaries of any "taxable" amounts of money or other benefits they will be receiving from the estate.
- Before distributing any property to the beneficiaries, the executor must obtain a clearance certificate from CRA that certifies all the above applicable taxes have been paid.
- If the executor does not get a clearance certificate, he or she can be personally liable for any amount of tax that the deceased owes.

The clearance certificate is requested by filing the prescribed form TX19. The form should be mailed to CRA only after the notice of assessments has been received for all the returns that are required to be filed and the taxes owed have been paid.

The form must be filed together with

- a copy of the Will,
- all probate documents, and
- a statement showing a list of assets (with market values) owned by the deceased at time of death.

CRA will usually accept the copy of the statement of assets and liabilities included in the probate documents.

The estate of a deceased individual may file multiple tax returns as the deceased's final filing. That allows for the deceased to claim personal tax credits on more than one return and reduce the income tax otherwise payable.

The estate of a deceased individual may file up to three tax returns if there is

- an income from "rights or things,"
- business income from a partnership or sole proprietorship, and
- earned income from a testamentary trust.

Rights or Things

- Salaries, commission, and vacation pay earned but not received at time of death
- Dividends declared but unpaid
- Unclipped matured bond coupons

On each optional return, a claim can be made for the basic personal amount, age amount, spouse amount, claim for eligible dependants, and caregiver amounts.

When individuals die, they are deemed to have sold their assets at fair market value at the time of death. Any capital gain or loss is included in their final tax return. If there is a surviving spouse, the assets—valued at their original costs—can be transferred to the spouse on a tax-free basis.

In the event the deceased individual had capital losses from other years, the transfer to the spouse of the losses can be done at fair market value to utilize the losses. The new-cost basis of the property transferred to the surviving spouse will be the fair market value at the time of death.

Typically, the most common assets transferred at death are the family home, real estate investments, portfolio investments, registered retirement instruments, and personal possessions.

Family Home

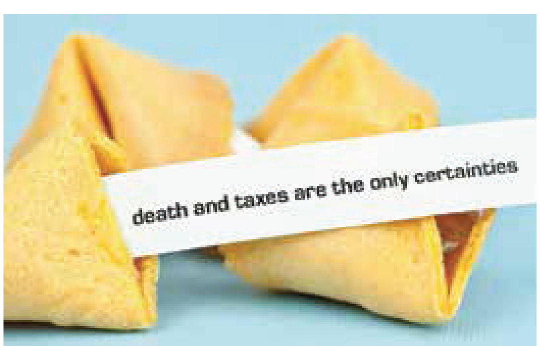
The gain on the value of the family home will qualify for the principal-residence exemption. Assuming no other property has been designated as a principal residence, no income tax will be payable on the home.

Investments

Investments in GIC or T-bills do not appreciate in value and can be transferred to a beneficiary without tax consequences.

- Any income earned prior to death is included in the final tax return.
- Any income earned after death is taxable to either the estate or the beneficiary.

Investments in real estate, stocks, mutual funds, and bonds whose value fluctuates may generate a capital gain or loss that is included in the final tax return. Particular attention must be paid to determine the cost of the assets to calculate the proper gain or loss. **For this purpose, it is important that the deceased kept good documents and records of all his or her investments.**



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A review of the 1994 income tax return is required to determine if the capital gain exemption election was filed to increase the cost of any investment to the extent of the capital gain exemption available (in 1994) of up to $100,000.

The rule of the deemed disposition at fair market value at the time of death gives rise to a basic estate-planning strategy.

If there are assets to be distributed to the surviving spouse and to other beneficiaries, consider

- leaving assets to the spouse that have **increased in value**, and
- leaving assets **with no increase in value** such as cash and GICs to the other beneficiaries.

Any income earned after death is taxable to either the estate or the beneficiary.

Registered Retirement Savings Plans

If the RRSP has not yet matured, the fair market value of the RRSP is included in the deceased's income in the year of death. There are, however, a few exceptions to the rule.

- If the surviving spouse is the beneficiary, the funds can be transferred to the spouse's RRSP. The amount transferred is included in the spouse's income but an offsetting deduction will remove any tax due on the transfer.
- If the estate is named as a beneficiary and there is a surviving spouse, the executor and the surviving spouse can file a joint election with CRA allowing the transfer of the RRSP funds from the estate to the RRSP of the spouse.
- If there is no surviving spouse, any amounts paid to a dependent child or grandchild will be included in the income of the child. If the child is younger than 19, the income can be deferred by rolling the RRSP to an "age 18 annuity." That annuity requires all the funds to be paid to the child before the age of 19.
- If there is no surviving spouse and the child or grandchild is financially dependent due to a physical or mental infirmity, the funds may be rolled tax-free into the RRSP of the child or grandchild.

Registered Retirement Savings Plans

When the deceased owns an RRIF, the market value of the RRIF at time of death is included in the deceased's income. As with the RRSP, there are exceptions for the RRIF.

- If the annuitant of the RRIF made a written election on the RRIF contract or in the Will, to continue the RRIF payments to the surviving spouse after death, then the surviving spouse becomes the annuitant and pays tax on future RRIF payments.
- If the deceased neglected to select the spouse as the recipient of the RRIF, it is still possible to designate the surviving spouse as the beneficiary of the RRIF. The legal representative, the executor, must consent to the spouse becoming the annuitant of the RRIF.
- If the beneficiaries of the RRIF are dependent children, the same rules for the RRSP apply to the RRIF.

Tax Free Savings Account

The tax implication of the TFSA at time of death will depend on the type of beneficiaries and if any income is earned after the date of death. Technically, the tax-free nature of the plan ceases immediately before death. There is no income inclusion for the deceased, but future earnings in the plan become taxable from the time of death.

If the TFSA contract named a successor holder, however, the survivor will become the new holder of the TFSA.

In the year of death, some rules for deductions and claims of tax credits are more generous.

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Charitable Donations

The inclusion rate of the amount of donations that are eligible for the tax credit is increased from 75 to 100 percent. Any donations that cannot be claimed in the year of death can be carried back to the previous year and applied at the 100 percent inclusion rate; all donations made in the Will of the deceased are deemed to be made in the year of death.

Medical Expenses

The general rule provides that medical expenses may be claimed for any 12-month period ending in the year of death, to the extent that they exceed the lesser of 3 percent of the deceased's net income and an amount set from year to year. The legal representative (the executor) of the deceased may claim, in the year of death, medical expenses paid within any 24-month period, which includes the date of death, but the same expenses cannot be claimed more than once.

Net Capital Losses

Generally allowable capital losses are deductible only against taxable capital gains. That limitation is removed in the year of death and in the immediately preceding year. All allowable capital losses and net capital-loss carry-forwards may be deducted in computing the taxable income in the year of death and the year preceding death.

As I learned from the BC Notaries' Executor Administration Course, the executor must, from the very beginning, take all the necessary steps to protect the estate of the deceased. That can be a stressful task during emotional times.

Protecting the estate also means ensuring the income tax due at death is minimized by taking advantage of all the rules and elections available. It is highly recommended that you consult professional advisors before any financial decisions are made that affect the estate of the deceased. ▲

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