MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

Are You Able to Rollover your Registered Plan to a Registered Disability Savings Plan (RDSP)?

Mackenzie Tax & Estate Planning

The RDSP was launched in December 2008 in an effort to help build long-term financial security for persons with disabilities and their families. The RDSP makes it easier to accumulate funds by providing assisted savings and tax-deferred investment growth.

Since the launch of the RDSP several improvements have been made to the plan making it more enticing for persons with disabilities to set up accounts. One area of improvement is with respect to the rollover of registered plans to an RDSP. An RRSP, RRIF, RPP and an Accumulated Income Payment (AIP) from an RESP can be rolled into an RDSP on a tax-deferred basis. This cannot be done by everyone however – in order for this to be possible several conditions must exist. This white paper will discuss the rules and the options available.

1. Why Rollover to an RDSP Rather than an RRSP?

The Federal Budget of March 3, 2010 made changes to the RDSP rules and introduced the ability to rollover registered assets of a deceased parent or grandparent to an RDSP of which a financially dependent disabled child or grandchild is beneficiary. This was done in an effort to provide parents and grandparents with more flexibility in providing for their disabled child or grandchild's financial security in the future. This budget provision received Royal Assent on December 15, 2010, however deaths occurring after March 3, 2010 may be eligible.

In order to be eligible for the rollover of RRSP funds to the RDSP beneficiary, the funds must be considered a 'refund of premiums'. In the case where the RRSP is left to a child or grandchild with a mental or physical infirmity, the child/grandchild must be financially dependent upon the deceased annuitant for support at the time of death. Determining whether someone is financially dependent can be a challenge. It is not always a requirement that the child or grandchild live with the deceased in order to be considered financially dependent on them. Generally, that is the case but it is not a requirement. Once financial dependence has been confirmed the next step is to ensure the beneficiary's income is less than the basic personal exemption plus the disability amount, which is indexed to inflation every year ($19,475 for 2016). If the RDSP beneficiary has net income above this amount they would likely not be considered to be financially dependent, and as a result would generally not qualify for the rollover. It is important to note that the rollover can only be from a parent or grandparent to the financially dependent child or grandchild; it is not possible to do a rollover to a dependent spouse's RDSP account. A spousal rollover can only be done from the deceased spouse's RRSP or RRIF to the surviving spouse's RRSP or RRIF, to an annuity.

One feature of the rollover is that the tax-deferred transfer from the parent's or grandparent's registered plan can reduce the amount of tax paid by the estate while protecting social assistance benefits available to the RDSP beneficiary. This can provide not only RDSP funds for the RDSP beneficiary but also a potentially larger inheritance for other estate beneficiaries.

One thing to note is that the rollover proceeds do not qualify for the matching Canada Disability Savings Grant (CDSG). However, there is no Assistance Holdback Amount (AHA) applicable to money contributed through a rollover. The AHA applies to any CDSG or Canada Disability Savings Bond (CDSB) that has been received in the 10 year period prior to a withdrawal from the account. Where the AHA applies, either all or a portion of the CDSG & CDSB must be repaid when a withdrawal is made. If $200,000 is rolled into a beneficiary's RDSP account, since no CDSG is applicable to the rollover amount, withdrawals can begin at any time. Therefore the rollover should be considered when it can provide immediate cash flow to the RDSP beneficiary.

An RDSP is not considered an asset for purposes of provincially sponsored social assistance benefits, and in most provinces, income from the RDSP would not affect these benefits. There are three provinces (Quebec, New Brunswick and Prince Edward Island) where there is a limited amount of income that can be withdrawn from the account without affecting benefits. For Quebec, the maximum is $950 per month New Brunswick allows monthly income of $800, which will be adjusted due to fluctuations in the Low Income Cut-Off (LICO). In Prince Edward Island an individual's income will only be exempt as long as it does not exceed the low-income level defined by the National Council of Welfare. This is an important point because a rollover to a disabled child or grandchild from a registered plan to an RRSP or RRIF belonging to the disabled beneficiary would fail the asset test in all provinces, and withdrawals made from the RRSP or RRIF would be included in income in all provinces. This could mean suspension of provincial benefits that may be available if the estate proceeds are invested in an RRSP rather than an RDSP.

Estate Tax Benefits of Rollover

When an annuitant passes away up to $200,000, subject to available RDSP contribution room, can be transferred to the beneficiary's RDSP, assuming the transfer qualifies under the tax rules. How effective is this type of rollover? Here is an example that demonstrates the potential tax savings available.

- Jane passes away at age 80 and had $500,000 in her RRIF.
- She has one son, James, who is disabled and financially dependent on her.
- She has a daughter who is not disabled.
- If there is no rollover the full $500,000 is taxable to Jane's estate; at a 45% tax rate, the tax liability would be $225,000.
- If on the other hand $200,000 is rolled into James' RDSP account this would leave $300,000 that would be taxable to Jane's estate.
- At the same 45% tax rate, $135,000 would be payable in tax rather than $225,000.
- This is a savings of $90,000 to Jane's estate, leaving $165,000 to be distributed to the daughter instead of $137,500.
- James would then pay tax on his RDSP income (at his tax rate) when withdrawn from his account. This could also have been achieved if the money was transferred to James' RRSP account but in doing so his provincially sponsored social assistance benefits would have been affected.

Taxation of Rollover

When an RRSP/RRIF or RPP annuitant passes away and the funds are withdrawn from the account a T4RSP or T4RIF will be issued. This withdrawal is included on line 129 of the deceased's final tax return. Any amount that is rolled into an RDSP is deducted on line 232. In addition, the amount rolled over to the RDSP is also included on line 129 of the RDSP beneficiary's tax return, with an offsetting deduction claimed on line 232.

In order to complete the rollover process, CRA form 4625 – Rollover to a Registered Disability Savings Plan (RDSP) Under Paragraph 60(m) must be completed. This form is included with the tax returns of both the deceased and the beneficiary for the year of the rollover. This allows the Canada Revenue Agency (CRA) to see where the money came from and where it is going.

2. Registered Education Savings Plan Rollover

Budget 2012 made changes to the RDSP that allow an Accumulated Income Payment (AIP) from an RESP to be rolled over to an RDSP on a tax-deferred basis. An accumulated income payment represents RESP growth that will not be used for education purposes. It does not include original contributions or RESP grants or bonds. A tax-deferred AIP rollover to an RDSP is possible as long as the conditions outlined below are met and the plans have a common beneficiary. This provides greater flexibility for parents who contributed to an RESP for a child who is unable to attend post secondary education due to a severe disability. In order to be eligible the beneficiary must meet existing age and residency requirements for RDSP contributions and one of the following conditions must be met:

1. The beneficiary has a severe and prolonged mental impairment that can reasonably be expected to prevent the beneficiary from pursuing post-secondary education;
2. The RESP has been in existence for at least 10 years and each beneficiary is at least 21 years of age and is not pursuing post-secondary education; or
3. The RESP has been in existence for more than 35 years.

If one of these conditions is met, the AIP can be rolled over from the RESP to the RDSP. The rollover is done on a tax deferred basis and the 20% penalty tax that would normally apply if the subscriber were to receive an AIP directly would not apply. The rollover amount is taxable to the RDSP beneficiary when withdrawn from the RDSP.

The AIP rollover cannot exceed (and will count against) the beneficiary's $200,000 lifetime contribution limit and is not eligible for matching CDSG. When the RESP is collapsed after-tax contributions that were made to the RESP will be returned to the subscriber tax-free (since the contribution was originally made with after-tax dollars). The subscriber can choose to contribute the after-tax contributions to the RDSP. If they do this, the contribution is considered new money that would be eligible for CDSG.

It is important to note that if there were grants and bonds in the RESP when it was collapsed, these must be repaid to the Government.

Rollover Process

In order to initiate a rollover of an AIP from an RESP to an RDSP a Registered Education Savings Plan (RESP) AIP Rollover to a Registered Disability Savings Plan (RDSP) form must be completed. In addition, a letter of direction needs to be included that gives specific details of the rollover including details on the current issuer of both the RDSP and RESP; beneficiary information for both accounts and subscriber information for the RESP. The letter of direction and rollover form are sent to Mackenzie (along with an RDSP application if the RDSP does not already exist), either by fax or mail, and Mackenzie will forward it to the RESP promoter to obtain the RESP promoter's authorized signature. The RESP promoter will then forward the AIP to Mackenzie to be deposited to the RDSP on a tax-deferred basis.

Let's look at an example:

John is the subscriber on an RESP for his daughter Sarah. It has been determined that Sarah has a severe and prolonged impairment and will not be able to attend post secondary education.

The current RESP account value is $25,200, of this $20,000 represents John's original contribution, $4,000 represents grant and $1,200 is the accumulated income. Sarah is beneficiary of the RESP, and also of an RDSP, and has met the eligibility requirements outlined above, so is eligible for the rollover of the AIP to the RDSP. In order to accomplish this the RESP must be terminated; the $20,000 John contributed to the account will be returned to him tax-free. The $4,000 in grant must be returned to the government and the $1,200 AIP will be transferred into Sarah's RDSP. The 20% penalty tax that normally applies when an AIP is withdrawn is waived on rollover to an RDSP. The AIP rollover will not be eligible for grant but John can choose to contribute some or all of the money he received when the RESP was terminated to the RDSP. Since these contributions would be considered new money they would be eligible for RDSP grant based on the family income thresholds.

Summary

There are several benefits of rolling a registered plan to an RDSP. Whether it be an RRSP/RRIF/RPP rollover or the rollover of an RESP AIP, it can be extremely beneficial. If you are interested in more information please speak with your financial advisor.

GENERAL INQUIRIES

For all of your general inquiries and account information please call:

ENGLISH	1-800-387-0614	
BILINGUAL	1-800-387-0615	
ASIAN INVESTOR SERVICES	1-888-465-1668	
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This should not be construed to be legal or tax advice, as each client's situation is different. Please contact your own legal and tax advisor.

The Canada Disability Savings Grant (CDSG) and the Canada Disability Savings Bond (CDSB) are provided by the Government of Canada. Eligibility depends on family income levels. Please speak to a tax advisor about RDSP's special rules; any redemptions may require repayment of the CDSG and CDSB.

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