MACKENZIE
Investments

Registered Disability Savings Plan

Can you roll over your registered plan to an RDSP?

Enabling Canadians, with RDSPs made easy.

Canadians with disabilities often face unique financial barriers, due to higher than average medical expenses and, in some cases, employment obstacles. Many may face an uncertain financial future. A Registered Disability Savings Plan (RDSP) offers an opportunity to build a more secure future, making it easier to accumulate funds in a tax-deferred environment.

Since the launch of the RDSP, several improvements have made it more enticing for persons with disabilities to open accounts. One area of improvement allows the tax-deferred rollover of registered plan assets to an RDSP. These include Registered Retirement Savings Plans (RRSP), Registered Retirement Income Funds (RRIF), Registered Pension Plans (RPP) and an Accumulated Income Payment (AIP) from a Registered Education Savings Plan (RESP). However, several conditions must be met. Below we will discuss the rules and the options available to ensure a successful rollover.

Why roll over to an RDSP rather than an RRSP?

A parent or grandparent may wish to leave registered plan assets to a child or grandchild with a disability as part of their estate plan. One of the options now available is to roll the registered plan assets directly over to an RDSP for the child or grandchild, on a tax-deferred basis, assuming certain conditions are met. This provides the parents or grandparents with another tax-efficient option for leaving an inheritance to a loved one with a disability.

To qualify 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 for support at the time of death.

In some cases, determining financial dependence can be a challenge. One example may be where a grandparent is planning to leave their RRIF to a grandchild's RDSP, where the grandchild is supported by their parents. It may be a challenge in this case to demonstrate that the grandparents provide financial support at the time of their death to the grandchild. There are several factors that determine dependency.

The goal was to give them more flexibility to provide greater financial security for their loved one with a disability.

Once financial dependence has been confirmed, the next step is to determine if the beneficiary meets the income test. The presumption is that an individual with a disability is dependent for support if their income is less than the basic personal exemption plus the disability amount for the year. This presumption can be rebutted by factual evidence to the contrary, meaning that it may be possible to demonstrate that the individual with a disability is dependent for support if their income exceeds the income test, based on their personal circumstances.

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 that may be available to the RDSP beneficiary. This can provide funds for the RDSP beneficiary and also a potentially larger inheritance for other estate beneficiaries.

It's important to note 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 and 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.

If the account received CDSBs in the 10 years prior to the withdrawal the proportional repayment rules will apply.

An RDSP is not considered an asset for purposes of provincially sponsored social assistance benefits, and in most provinces income from the RDSP would also not affect these benefits. For residents of Quebec, New Brunswick and Prince Edward Island, there is a limit to the 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.

Therefore, the rollover should be considered when it can provide immediate cash flow to the RDSP beneficiary.

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, if the transfer qualifies under the tax rules. How effective is this type of rollover? Here is an example to demonstrate the potential tax savings.

Jane passes away at age 80 and had $500,000 in her RRIF.

She has one son, James (who has a disability), who is financially dependent on her.

$500k RRIF

She also has a daughter.

No rollover: $225,000 tax

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**.

With rollover: $135,000 tax

If, on the other hand, $200,000 is rolled into James' RDSP, only the $300,000 would be taxable to Jane's estate. At the same 45% tax rate, **$135,000** would be payable in tax rather than $225,000.

$90,000 savings

This is a savings of **$90,000** to Jane's estate, leaving $165,000 to be distributed to the daughter instead of $137,500.

Tax only paid on withdrawal

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 provincial social assistance benefits may have been reduced.

Taxation of rollover

When an RRSP/RRIF or RPP annuitant passes away and the funds are withdrawn from the account, a T4RSP or T4RIF is issued. This withdrawal is included on line 12900 of the deceased's final tax return. Any amount that is rolled into an RDSP is deducted on line 23200.

In the RDSP beneficiary's tax return, the rollover amount is also included on line 12900, with an offsetting deduction claimed on line 23200.

In order to complete the rollover process, CRA form RC4625 – 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.

Registered Education Savings Plan (RESP) rollover

The 2012 Federal Budget made further changes to the RDSP to allow an Accumulated Income Payment (AIP) from an RESP to be rolled over to an RDSP on a tax-deferred basis. An AIP 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 if 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.
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 and 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 must 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 to be 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 of 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 postsecondary education.

The current RESP account value is $25,200, of which $20,000 represents John's original contribution, $4,000 represents the grant and $1,200 is the accumulated income. Sarah is the beneficiary of the RESP and also of an RDSP, and has met the eligibility requirements outlined above 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 CDSG, but John can choose to contribute some or all of the money he received when the RESP was terminated to the RDSP. This would be considered new money and would be eligible for the RDSP grant, based on the family income thresholds.

$25,200 RESP = **$20,000** John's original contribution. + **$4,000** Government grant. + **$1,200** Accumulated income payment (AIP).

To rollover without tax penalty:

1. Terminate RESP.
2. $20,000 returned to John tax-free.
3. $4,000 grant returned to gov't.
4. $1,200 AIP transferred to RDSP.

Peace of mind starts with a conversation.

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.

Speak with a financial advisor to help you navigate through the various options and help determine the best fit for you.

For more detailed information on RDSP plans, please visit us at mackenzieinvestments.com/RDSP.

General Inquiries.

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Find fund and account information on-line through Mackenzie Investments' secure InvestorAccess. Visit mackenzieinvestments.com for more information.

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 the RDSP's special rules; any redemptions may require repayment of the CDSG and CDSB.

3511531 TE1071 02/2024