



TAXATION OF ASSETS THAT PASS OUTSIDE OF AN ESTATE

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When a person leaves a financial asset like an RRSP, a RRIF, or a trust annuity to a beneficiary using a beneficiary designation, that asset will typically pass outside of probate; as a general rule, the beneficiary will not be required to pay any tax on the gift. Under certain circumstances, however, such a gift may be taxable in the hands of the beneficiary as a result of the *Income Tax Act* (the “**Act**”).¹ This month’s Solicitor’s Tip explores when a beneficiary may have to foot the bill for taxes.

Solvent Estates Are Responsible for Taxes on Assets That Pass Outside of Probate

During an estate administration, there is a basic rule – the debts of the deceased must be paid by the estate before the estate can be distributed.² In fact, the deceased’s will often specifically directs that the deceased’s debts are to be paid out of the estate.³ In keeping with this basic rule, and in recognition of subsection 153(1) and section 159 of the *Act*,⁴ primary responsibility for the deceased’s income tax rests with the estate, even for financial assets that pass outside of the estate.⁵

It is only if the deceased’s estate is insolvent that the Canada Revenue Agency (the “**CRA**”) can seek payment of the deceased’s tax debt from the beneficiary of an asset that passes outside of the estate. The CRA’s ability to pursue a beneficiary ultimately depends on the type of asset paid or transferred to the beneficiary, and the specific terms of the *Act*.⁶ Section 160.2, discussed below, is one such provision that can be used to impose tax liability on a beneficiary.

Joint and Several Liability for Amounts Received From RRSPs, RRIFs and Trust Annuities

When a benefit is paid out of an RRSP, RRIF, or trust annuity, resulting in a tax liability, subsections 160.2(1), (2) and (2.1) of the *Act* provide that the tax payer and the recipient of the benefit are jointly and severally liable to pay the tax from the year that the benefit was received.⁷ The Tax Court of Canada has referred to this section as “a collection mechanism” that only applies where the value of the estate is less than the tax liability and “the estate cannot pay the taxes or ‘is in default of paying the taxes otherwise due.’”⁸

¹ [RSC 1985, c 1 \(5th Supp\)](#) [*ITA*].

² See the *Estates Administration Act*, [RSO 1990, c E.22](#), s. 5.

³ See, for example, *Bélanger v The Queen*, [2007 TCC 502](#) [*Bélanger*] at para. 3.

⁴ *ITA*, *supra* note 1, ss. 153(1), 159.

⁵ See *Curley v. MacDonald*, [2000 CanLII 22836](#) (Ont SCJ) [*Curley*]. Other provisions in the *ITA*, *supra* note 1, may also require the deceased’s estate to pay taxes on assets that pass outside of probate. For example, see *Bélanger*, *supra* note 3 at paras 7-8, where Justice Angers held that the deceased’s estate was liable to pay the income tax owed on the deceased’s RRIF pursuant to section 146.3 of the *ITA*.

⁶ *Supra* note 1.

⁷ *Ibid.*, ss. 160.2(1), (2), (2.1).

⁸ *Curley*, *supra* note 5 at para 11, citing Anne E.P. Armstrong, *Estate Administration* at p. 5-24.

Under certain circumstances, the CRA is not obligated to seek payment of a tax liability from the estate before pursuing payment from a beneficiary *via* section 160.2 of the *Act*. For example, the Tax Court has held that the CRA is not required to seek payment from an estate first if there is reason to believe that the estate has insufficient funds to pay the deceased's taxes.⁹ On a related note, the Court may also decline to seek payment of an estate's debt from the estate trustee or executor personally before pursuing a beneficiary.¹⁰

If an estate is insolvent but the beneficiary named in an instrument subject to section 160.2 of the *Act* resides outside of Canada, collecting the tax debt or other recourse may not be available to the CRA against the beneficiary.¹¹ If the country where the beneficiary resides has entered a tax collection treaty with Canada, however, the CRA may still be able to pursue the beneficiary for the outstanding tax liability.¹²

Strategies for Distributing Assets That Pass Outside of an Insolvent Estate

If it appears that an estate is insolvent, any trustee who holds an asset that passes outside of the estate, such as a RRSP, a RRIF, or a trust annuity, may be inclined to think that it is a good idea to refrain from distributing those assets until the estate has obtained a tax clearance certificate. After all, if the estate is insolvent and unable to pay the deceased's taxes, any taxes owing on said instruments will be deducted from those instruments. However, delaying the distribution of such assets that pass outside of the estate may not be suitable – as noted in a CRA letter discussing insolvent estates, requiring a trustee to wait until all amounts the deceased is liable for under the *Act* have been paid “would create economic havoc and unreasonable delays.”¹³

If an estate trustee is holding the proceeds of an instrument subject to section 160.2 of the *Act* and is concerned that the estate will be insolvent, one solution is to estimate the taxes payable on the instrument, creating a holdback for that amount, and issuing an interim distribution of the asset until a clearance certificate is obtained. Alternatively, if the asset is distributed directly to the beneficiary, it may be prudent for the estate trustee to advise the beneficiary that the asset may be taxable in their hands if the estate turns out to be insolvent.

If a beneficiary is liable for taxes under section 160.2 of the *Act*, they may wish to consider making payment of those taxes directly to the Receiver General. If a beneficiary pays the estate trustee for a tax liability but the CRA does not receive full payment of the tax debt, the CRA may still pursue the beneficiary for payment of the outstanding taxes – in fact, any payment made to the estate trustee will not be considered when calculating the deceased's tax liability under the *Act*.¹⁴

Stay Tuned for Next Month's Solicitor's Tip

In next month's Solicitor's Tip, we will continue this conversation by addressing when an asset that passes outside of an estate can be taxed in the hands of the beneficiary under section 160 of the *Act*.

⁹ *O'Callaghan v The Queen*, [2016 TCC 169](#) at para 26 [*O'Callaghan*].

¹⁰ See *Bélanger*, *supra* note 3 at para 5, where Justice Angers held that the “Court has no jurisdiction to hold the executor of the estate accountable.”

¹¹ See 8 September 2011 T.I. 2011-040239117 – Insolvent Estate of a Deceased RRSP Annuitant, online: Income Tax Severed Letters <<https://taxinterpretations.com/cra/severed-letters/2011-040239117>> [Severed Letter].

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ See *O'Callaghan*, *supra* note 9 at para 27.