A Spousal Rollover May Not Always Make Sense

Having a surviving spouse* may provide flexibility for capital property or property held in a registered plan upon your death. This is because the Income Tax Act permits the use of a spousal rollover.[1] A spousal rollover allows such property to be transferred to a surviving spouse and any associated capital gains or registered plan income will be deferred until the spouse disposes of, or is deemed to have disposed of, those assets (or withdraws the assets, in the case of a registered plan).

Using the spousal rollover has become an almost automatic strategy for many estate plans. However, in some cases, there may be reasons why it may not make sense. Why? While deferring taxes is often beneficial, it can also result in unintended consequences. Take, for example, a surviving spouse who ends up with a very high income due to the rollover of their deceased spouse's Registered Retirement Income Fund (RRIF), increasing their minimum annual withdrawal requirements. With this higher income, the spouse is now subject to the Old Age Security (OAS) clawback and a higher marginal rate of tax.

Given the reduced OAS benefit and higher annual taxes, some forward planning could potentially have reduced the overall lifetime tax-related burden. It may have been better for the deceased spouse to bleed down their RRIF in the years of having a lower marginal tax rate. Or, perhaps the RRIF could have been partially converted to cash upon death, with a portion transferred to the surviving spouse.

Electing to Not Use the Spousal Rollover

Be aware that an automatic rollover of capital property, for tax purposes, occurs upon the death of the first spouse. However, an election can be made to not use the spousal rollover on a property-by-property basis. Here are some other situations in which electing to not use the spousal rollover may make sense:

- The deceased's marginal tax rate is low on the date-of-death return.
- The deceased has capital losses carried forward from previous years that can be used to offset some of the realized capital gains.
- The deceased owns qualified small business corporation shares with unrealized capital gains and an unused lifetime capital gains exemption (LCGE).
- The deceased has property with an accrued loss, which may be used to offset accrued capital gains on other properties.

Having flexibility in tax planning by using — or not using — the spousal rollover may have its benefits. Please seek the advice of a tax planning expert as it relates to your particular situation.

*Or common-law partner; 1. For tax purposes, a person is generally deemed to have disposed of their capital property at fair market value immediately before death. Even though there may not have been an actual sale, there may be associated gains or losses realized for tax purposes. Also, unless a rollover is available, the fair market value of a registered plan is included in the deceased's income in the year of death. A spousal rollover is available where property is transferred to a surviving spouse or common-law partner.