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Filing Tax Returns Upon Death

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Coping with the death of a loved one is a difficult and emotional task on its own. In addition to making funeral arrangements and locating the will, the appointed executor must also take on the daunting task of trying to organize the deceased's financial affairs.

The executor will need to compile a complete list of the deceased's assets held at the time of death before beginning the process of applying for probate, if necessary. All pertinent financial institutions, credit card companies, pension plan administrators and government departments will need to be notified of the individual's death in order to cancel all credit cards, pension benefits and their Social Insurance Number. In addition to all of this, income tax returns must also be filed for the deceased's final year.

You Have The Responsibility

As the legal representative of the deceased, you are responsible for filing all required returns on their behalf. This may include filing tax returns for years prior to their death if the deceased was not up-to-date in their filings. It is also your responsibility to ensure that all taxes owing are paid from the deceased's estate and to inform the beneficiaries if any inheritances they are to receive would be considered taxable.

In order to begin the preparation of the final tax returns, the executor needs to determine all sources of the deceased's income. This can be accomplished by checking previous returns to help create a list of employers and investment companies the deceased may have received income from in the past. The executor will likely have to contact employers, banks, investment advisors and pension plan managers to ensure they have all the required income information and that all appropriate tax slips are received on behalf of the deceased. Lastly, if a safety deposit box exists, it should be checked for information leading to any other sources of income and benefits.

Depending on the contents of the will and whether or not the deceased has a surviving spouse or common-law partner, the income to be included on the deceased's tax return can vary. The same holds true with respect to any credits and deductions available and what type of elections can be made on the deceased's income tax return. For example, there is a deemed disposition of the deceased's assets at their fair market value at the date of their death; however, the tax treatment differs depending on the asset held. If the deceased held an active registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF), the final tax return must include any payments received in the year of death. If the deceased has a surviving spouse or common-law partner whom they have elected to receive the plan in the event of their death, the spouse or common-law partner will become the annuitant of the plan and the RRSP or RRIF payments will continue to be paid to them accordingly. However, if the deceased does not have a surviving spouse or common-law partner, the deceased is deemed to have received an amount equal to the fair market value of the plan at the time of their death. This amount would then be included in the deceased's income for their final year.

If the deceased held capital property, such as an investment portfolio or real estate that is not being transferred to a surviving spouse or common-law partner, there would be a deemed disposition of the property at the fair market value at date of their death. When the capital property is sold, any gain or loss from the sale of the property would be reported on a T3 Trust Income Tax and Information Return. If capital losses are incurred, it is possible for a special election to be made to have them applied to the deceased's final tax return thereby reducing the tax liability that may have been incurred.

On the final income tax return, commonly referred to as the "terminal return", the executor must report the deceased's income from January 1 of their final year, up to and including the date of their death. If the deceased died between January 1 and October 31, the terminal return must be filed and any taxes owing must be paid by April 30 of the following year. If the deceased died in November or December, the terminal return and any taxes owing are due six months after the date of death. If the deceased or their surviving spouse was self-employed and the date of death occurred between

January 1 and December 5, the due date of the final return would be June 15 of the following year; however, if the deceased's death occurred between December 16 and December 31, the final return is due six months after the date of death.

Optional Returns

There are three optional returns that could be filed for the deceased:

- Rights and things return
- Return for a partner or proprietor
- Return for income from a testamentary trust

Rights and things return

"Rights and things" are amounts that had not been paid to the deceased at the time of their death and, had the individual not died, would have been included in their income once received. Rights and things can include:

- Salary, commissions and vacation pay owed to the deceased for a pay period that ended before the date of their death
- Old Age Security benefits due and payable before death
- Uncashed matured bond coupons
- Bond interest earned to a payment date before death, but not paid nor reported in previous years
- Unpaid dividends declared before the date of death
- Supplies on hand, inventory and accounts receivable if the deceased was a farmer or fisherman using the cash method
- Livestock that is not part of the basic herd and harvested crops if the deceased was using the cash method
- Work in progress if the deceased was a sole proprietor and a professional who elected to exclude work in progress when calculating his or her total income.

A rights and things return must be filed by the later of 90 days after receipt of the notice of assessment for the final return, or one year after the date of death.

Return for a partner or proprietor

If the deceased was a partner or sole proprietor of a business, an optional return may be filed if the business has a fiscal year that does not start or end on the same dates as the calendar year. If the individual passed away after the end of the fiscal period for that business but before the end of the calendar year, a return can be filed to report income for the time from the end of the fiscal year period to the date of death. The filing due date for this optional return coincides with the terminal return.

Return for income from a testamentary trust

If the deceased received income from a testamentary trust, an optional return can be filed for as the trust may have a fiscal period that does not start or end with the calendar year. If the individual passed away after the end of the fiscal period of the trust, but before the end of the calendar year, this optional return can be filed to report the income earned for the time from the end of the fiscal year period to the date of death. The filing due date for this optional return is the same as the terminal return.

Income Earned After Date of Death

Any income earned after the date of death must be reported on a T3 Trust Income Tax and Information Return. The executor can choose a year end for the estate provided it is within one year following the date of death. The T3 tax return must be filed within 90 days from the chosen year end of the estate.

As the executor, you may wish to apply for a clearance certificate before any property is distributed to the beneficiaries. Issued by the Canada Revenue Agency (CRA), a clearance certificate is obtained after all tax returns for the deceased have been assessed and certifies that all amounts for which the deceased was liable in terms of taxes and benefits has been paid. Without the certificate, the executor can be held liable for any amount the deceased owes to CRA. If the beneficiaries and the executors are one and the same, the need for a clearance certificate is not as significant.

Filing returns for the deceased can be complex as various tax laws apply and certain tax elections may be available given the deceased's situation. In order to ensure that all aspects are considered during this difficult time, it is always best to consult a tax professional.

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