RBC Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Estate planning for your TFSA

Throughout your life, many opportunities and choices will arise that have financial implications — both for the short- and long-term. Looking at these opportunities in the context of your overall financial plan will help you ask the right questions, so you can better understand the issues and make the best financial choices. This article discusses some of the advantages and disadvantages of naming one or more beneficiaries of your tax-free savings account (TFSA) and the tax implications for this type of plan at death. Beneficiary designations discussed in this article include:

- Designating your spouse or common-law partner
- Designating your minor child
- Designating a third party
- Designating a non-resident
- Designating a registered charity

For purposes of this article, any reference to a spouse includes a common-law partner.

Types of beneficiaries

You can designate either a successor holder or a beneficiary for your TFSA. A successor holder may only be your spouse. A beneficiary of a TFSA can be your spouse who you have not named as a successor holder, your children, a third party, or a registered charity. If you do not designate a successor holder or beneficiary on the TFSA plan documentation, your TFSA assets will form part of your estate and be distributed according to the terms of your Will or the applicable provincial or territorial intestacy laws.

If you live in Quebec, generally you can't name a successor holder or beneficiary of your TFSA on your plan documentation, unless the TFSA is an insured TFSA (i.e. it's tied to an insurance policy or annuity). Most TFSAs offered by banks and brokerage

firms are not insured TFSAs but instead are structured as deposits or trusts. When TFSAs are structured as deposits or trusts, you'll only be able to designate a beneficiary through your Will and there's no opportunity to designate your spouse as a successor holder.

How to designate a successor holder or beneficiary

In all common law provinces and territories, you may designate a successor holder or beneficiary of your TFSA by naming them on the plan documentation or in your Will. By making a designation on the plan documentation, you may simplify the administration of your estate for your executor and reduce probate taxes. You may also be able to reduce probate fees by naming a successor holder or beneficiary in the non-dispositive section of your Will. The non-dispositive section of a Will is the section that falls outside the body of the Will before the assets are vested in your executor. Please consult a qualified legal advisor if you're considering making a successor holder or beneficiary designation in your Will.

When appointing a successor holder by Will, the Will needs to state that the successor holder acquires all of your rights under the plan, including the unconditional right to revoke any beneficiary designation.

Many TFSA plan documents allow you to designate both a successor holder or primary beneficiary, as well as an alternate beneficiary or several beneficiaries. Keep in mind, however, that the alternate beneficiary designation will only take effect if the successor holder or primary beneficiary has pre-deceased you.

If you name a successor holder or beneficiary on your plan documentation, it's important to ensure the designation is consistent with any designation you may have made in your Will. If there's a conflict between the designation on your plan and the designation in your Will, generally, the later designation revokes the earlier one. If the financial institution holding your plan is unaware of a later designation you may have made in your Will, on your death, the institution will pay the assets directly to the beneficiary listed on the plan. This could lead to conflict between your heirs who may seek legal remedies and incur unnecessary expenses.

Taxation of your TFSA at death

The tax implication of holding a TFSA upon your death depends on two factors:

1. The type of TFSA you own, and
2. The type of beneficiary designation you've made and the person you've chosen to receive the funds.

In all common law provinces and territories, you may designate a successor holder or beneficiary of your TFSA by naming them on the plan documentation or in your Will. By making a designation on the plan documentation, you may simplify the administration of your estate for your executor and reduce probate taxes.

1)Types of TFSAs

Deposit or annuity contract

If you have a deposit or annuity contract under a TFSA and have not named a successor holder, the TFSA ceases to exist upon your death. You are deemed to have disposed of your TFSA assets for an amount equal to the fair market value (FMV) at the time of your death. The FMV of the TFSA as of the date of death is not taxable to you or your estate. All income earned and capital gains generated after your death will be taxable to your beneficiary and reported to them on the appropriate slips.

Trust arrangement

If you have TFSA trust and have not named a successor holder, the TFSA continues to exist after your death and remains non-taxable until the end of the "exempt period". The exempt period begins the day after your death and ends on December 31 of the year following your death. During the exempt period, any income earned in the TFSA is not taxed within the TFSA. If any payments are made to your beneficiaries during this period, only the portion in excess of the date of death value will be taxable to them. In other words, your beneficiaries can only make tax-free withdrawals from the TFSA up to the FMV on the date of your death.

If your TFSA trust has not distributed all of the funds by the end of the exempt period, your TFSA will become a taxable inter vivos trust and be required to file an annual trust return.

2)Types of beneficiaries

Designating your spouse

Your spouse as successor holder

If you name a successor holder of your TFSA, your spouse automatically becomes the holder of your account at the time of your death, and the TFSA continues to exist. Designating a successor holder is as simple as a name change on the account, regardless of whether the account is a deposit, annuity contract or trust. Your successor holder can make tax-free withdrawals or make contributions to that account after your death, depending on their own unused

TFSA contribution room. The value of the TFSA upon your death, as well as any income earned after your death, will continue to be sheltered from tax.

If your successor holder already has their own TFSA, they will now have two accounts. If they wish to consolidate their accounts, they can directly transfer part or all of the value from one account to the other. This transfer would not affect their TFSA contribution room.

Excess amount

If you had an excess amount in your TFSA at the time of death, the over-contribution amount now passes to your successor holder. The entire excess TFSA amount transfers to your successor holder at the beginning of the month after your death. If your successor holder does not have their own TFSA contribution room to absorb the over-contribution, they will incur the penalty tax of 1% per month until they remove the excess.

Your spouse as beneficiary

If you decide not to name your spouse as a successor holder, you can designate them as beneficiary of your TFSA. Your spouse will not have to pay tax on any of the payments made out of your TFSA, as long as the payments do not exceed the FMV of the assets held in your TFSA at the time of death. Any amount paid to your spouse that represents an increase in value of your TFSA after your date of death will generally be taxable to your spouse.

This is the major difference between designating your spouse as a beneficiary versus a successor holder. Where you name a successor holder, any income earned or growth realized after your death will continue to be sheltered from tax. Where you name a beneficiary, your beneficiary must generally pay tax on any increase in the value of your TFSA since your date of death.

If you name your spouse as beneficiary on your TFSA plan documentation or if your spouse is a beneficiary of your estate and is entitled to some or all of the TFSA proceeds, they will have the option (subject to certain restrictions) of making an "exempt contribution" of the TFSA proceeds to their own TFSA without affecting their own unused contribution room. In order to make an exempt contribution, your spouse must receive and contribute all or a portion of the TFSA proceeds to their own TFSA before the end of the calendar year following your year of death. Your beneficiary will need to designate the payments as an exempt contribution within 30 days after the day the contribution is made. The amount your beneficiary designates as an exempt contribution may not exceed the FMV of your TFSA at the date of death.

If you had an excess amount in your TFSA at the time of death, the over-contribution amount now passes to your successor holder. The entire excess TFSA amount transfers to your successor holder at the beginning of the month after your death.

Designating a third party as a beneficiary

You can designate a beneficiary (your child, grandchild or anyone else) on the TFSA contract or in your Will. Your beneficiary will not have to pay tax on payments made out of the TFSA as long as the total payments do not exceed the FMV of your TFSA at the date of death. Any amount paid to your beneficiary that represents an increase in the value of your TFSA after the date of death will generally be taxable to your beneficiary. If your beneficiary has unused TFSA contribution room, they can contribute all or part of the amount they receive to their own TFSA.

Leaving property to a minor

If you name a minor child as beneficiary of your TFSA, provincial or territorial laws that govern children's property may prevent them from directly receiving the TFSA proceeds. This is because a minor child does not have the legal capacity to receive the TFSA proceeds paid to them as beneficiary or provide a valid discharge to the financial institution administering the TFSA.

Depending on the value of your TFSA on death and the applicable provincial or territorial laws, the TFSA proceeds will generally need to be paid to a parent on behalf of the minor child, a court-appointed guardian of property for the minor child, the Public Guardian and Trustee, or into court. For example, in Ontario, if you name a minor child as the beneficiary of your TFSA, and the value of your plan on death exceeds $35,000, the proceeds will either need to be paid into court and held there until your beneficiary turns 18 or to a court-appointed guardian of property for your minor child. If the TFSA proceeds must be paid into court, there will be limited access to these funds until your child reaches the age of majority.

Applying to the court to be appointed as guardian of the minor child's property can be a time-consuming and expensive process. Consider whether the potential probate savings associated with naming your minor child as the beneficiary of your TFSA outweighs the costs and complexities involved with a guardianship application.

To avoid having a guardian of property appointed for your minor child or having the TFSA proceeds paid into court, you may choose to name your estate as the beneficiary of

your TFSA. In this case, with proper planning, your TFSA proceeds may pass to a testamentary trust created under your Will for the benefit of your minor child. If you set up a trust in your Will, you can specify the timing of the gift or define the circumstances in which your child will receive the funds. By utilizing this strategy, you may forgo the probate savings that result from naming your minor child as the beneficiary of your TFSA.

You should seek the advice of a qualified legal advisor in your province or territory before naming a minor beneficiary on your TFSA.

Designating a non-resident as a beneficiary

If the beneficiary you named is a non-resident, any payment that represents amounts earned above the FMV of the TFSA as of the date of death will generally be subject to non-resident withholding tax. Non-residents should not contribute to a TFSA. If they do contribute, they will be subject to a 1% tax for each month the contribution remains in the TFSA. For more information on non-residents of Canada holding TFSAs, please ask your RBC advisor for a copy of an article on the topic of TFSAs.

Designating a registered charity as a beneficiary

You may also name a registered charity as a beneficiary of your TFSA. This would result in a charitable donation tax receipt for the FMV of your TFSA at the time of donation. Your legal representative can use this receipt to claim a donation tax credit. They may have some flexibility in their use of the donation tax credit, which is beyond the scope of this article. Ask your RBC advisor for an article on charitable donations for more information.

If your TFSA earns any income or increases in value before the assets can be distributed to the charity, the income or capital gains generated will, in theory, be taxable to the registered charity in the year it's received. Since registered charities are tax-exempt entities, no tax should be payable on the income or capital gains generated in your TFSA after your date of death.

Assets form part of your estate

Where you have not named a successor holder or beneficiary, your TFSA assets will form part of your estate and be distributed to your beneficiaries according to the terms of your Will or, if you have no Will, the provincial or territorial intestacy laws. Any income earned or capital gains accrued in your TFSA to the date of death are exempt from tax. Any payments from your TFSA that represent an increase in the value of your TFSA after the date of death will generally be included in your estate's taxable income and either be taxed in the estate or in the hands of the beneficiary of your estate.

If the beneficiary you named is a non-resident, any payment that represents amounts earned above the FMV of the TFSA as of the date of death will generally be subject to non-resident withholding tax.

Decline in TFSA value after your death

If there's a decrease in the value of the TFSA between your date of death and the date of distribution to your named beneficiary or your estate, no tax relief is available to you, your beneficiary or your estate. A capital loss cannot be claimed by any party with respect to a post-death decline in value.

Post-death contributions

If you had any unused TFSA contribution room at the time of your death, your executor/liquidator can't make a post-death contribution to your or your beneficiary's TFSA to use up your unused TFSA contribution room.

Conclusion

When creating your estate plan, it's important to consider the appropriate beneficiary to inherit your TFSA. You should always consider your personal situation carefully and make decisions based on your own unique circumstances. You should also review all of your beneficiary designations regularly to ensure that they are up to date and that they reflect any changes to your personal or family situation.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



Wealth Management

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