

THE NAVIGATOR



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 situation and 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 plan at death. Beneficiary designations discussed in this article include:

- Designating your spouse
- Designating your minor child
- Designating a third party
- Designating a non-resident
- Designating a registered charity

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax 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 and legal advisor before acting on any of the information in this article.

TYPES OF BENEFICIARIES

You are able to designate either a successor holder or a beneficiary for your TFSA account. A successor holder may only be your spouse or common-law partner. For purposes of this article, any reference to a spouse includes a common-law partner. A beneficiary can include 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 provincial or territorial intestacy laws.

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. If you live in Quebec, you cannot name a successor holder or beneficiary on your plan documentation — you must do so



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If you name a successor holder or beneficiary on your plan documentation, it is important to ensure that the designation is consistent with any designation you may have made in your Will.

in your Will. If you name either on the plan documentation, this may simplify estate administration for your executor and minimize probate taxes. You may also be able to minimize probate taxes by naming a successor holder or beneficiary in the non-dispositive section of your Will. The non-dispositive section is outside the body of the Will. Please consult your legal advisor if you are 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 and an alternate beneficiary or several beneficiaries, but the beneficiary designation will only take effect if the successor holder is deceased.

If you name a successor holder or beneficiary on your plan documentation, it is important to ensure that the designation is consistent with any designation you may have made in your Will. In general, if there is a conflict between the designation on your plan and the designation in your Will, your 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 conflicts between your heirs who may seek legal remedies and incur unnecessary expenses.

TAXATION OF YOUR TFSA AT DEATH

The tax implications upon your death depend on two factors:

- 1) The type of TFSA you own (a deposit or annuity contract, or a trust arrangement); and
- 2) The beneficiary you have chosen to receive the funds.

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 on the appropriate slips (e.g., interest earned will be reported on a T5 slip).

TRUST ARRANGEMENT

If you have a 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 31st 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 and reported on a T4A as a “Tax-Free Savings Account taxable amount”. Your beneficiaries can only make tax-free withdrawals from the TFSA up to the

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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 T3, *Trust Income Tax and Information Return*. Any earnings or growth in value during the exempt period that is not distributed and reported on T4A slips to your beneficiaries during that time is reported as “other income” on the trust’s T3 tax return in its first taxable year. In addition, any income and capital gains realized during the first taxable year should be reported on that T3 tax return. The TFSA trust would then pay tax on that income from these three taxable years (the year of death, the following year, and the first year the TFSA becomes a taxable inter vivos trust), except to the extent it was distributed during that year and allocated to your estate or a beneficiary.

DESIGNATING 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 then make tax-free withdrawals from 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 your over-contribution, they will incur the penalty tax of 1% per month until they remove the excess.



If you name a minor child as a beneficiary of your TFSA, 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.

DESIGNATING 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 the FMV of your TFSA after your date of death will 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 pay tax on any increase in the value of your TFSA since the date of death.

If you name your spouse as beneficiary on your TFSA plan documentation or if your spouse is 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 on Canada Revenue Agency (CRA) Form RC240, *Designation of an Exempt Contribution Tax-Free Savings Account (TFSA)* and

submit the form within 30 days after they make the contribution. Lastly, the amount your beneficiary designates as an exempt contribution may not exceed the FMV of your TFSA at the date of death.

DESIGNATING YOUR MINOR CHILD AS A BENEFICIARY

If you name a minor child as a beneficiary of your TFSA, 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 minor child that represents an increase in the FMV of your TFSA after the date of death will be taxable to the child and reported to them on a T4A as a “Tax-Free Savings Account taxable amount”.

LEAVING PROPERTY TO A MINOR

If you name your 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 \$10,000, the proceeds

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.

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 outweigh 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 precise 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.

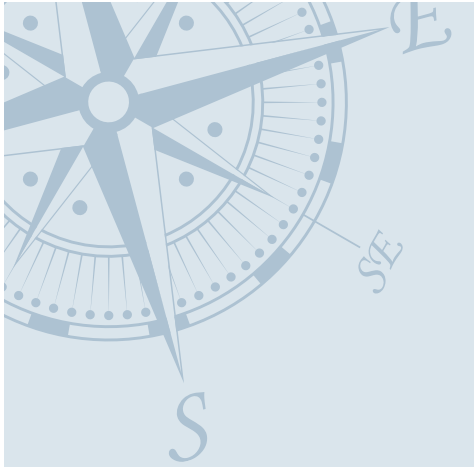
You should seek the advice of a qualified legal advisor in your province or territory before naming a minor beneficiary for your TFSA.

DESIGNATING A THIRD PARTY AS A BENEFICIARY

You can designate a beneficiary (your adult child 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 FMV of your TFSA after the date of death will be taxable to your beneficiary and reported to them on a T4A slip as a "Tax-Free Savings Account taxable amount". If your beneficiary has unused TFSA contribution room, they can contribute all or part of the amount they receive to their own 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 be reported on an NR4 slip and subject to non-resident withholding tax. Non-residents should not contribute to or open their own TFSA. Non-residents



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 the provincial or territorial intestacy laws.

contributing to a TFSA 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 refer to our article on the “Tax-Free Savings Account”.

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 on your final tax return. The transfer of funds to the charity must generally occur within 36 months following your death.

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 is 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.

As of January 1, 2016, if you name a registered charity as a beneficiary of your TFSA, the donation is deemed to be made by your estate. If the TFSA funds are transferred to the charity within 36 months following

your death, and your estate qualifies as a “graduated rate estate”, your legal representative can use the donation credit in the year of death or in the immediately preceding year. Alternatively, your legal representative can use the donation credit in your estate in the year the donation is made, carry it back to any of the estate’s prior taxation years, or carry it forward for up to five years.

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 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 FMV of your TFSA after the date of death will be included in your estate’s taxable income and either be taxed in the estate or in the hands of your beneficiary.

POST-DEATH CONTRIBUTIONS

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

Review all of your beneficiary designations regularly to ensure that they are up to date and that they reflect any changes to your personal family situation.

CONCLUSION

When creating your estate plan, it is 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 family situation.

Please contact us for more information about the topics discussed in this article.

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