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## What happens on the death of a TFSA holder?

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*Since its introduction in 2009, the tax-free savings account (TFSA) has become an investment vehicle of choice for over 8 million Canadians. The Department of Finance estimated that at the end of 2011, the value of assets in TFSAs was in excess of \$62 billion. Individuals, who since 2009 have made the maximum annual contributions and have not withdrawn any funds, will have \$31,000 plus accumulated income in their respective plans.*

When a TFSA holder dies, what happens to the funds in the account depends on whether the holder identified who the funds should be given to after his or her death and the relationship of that individual to the deceased immediately before death.

A TFSA holder may:

- Name a **successor holder** for the account, who essentially stands in the shoes of the deceased and becomes the account holder
- Designate a **beneficiary** for the account — the account will cease to exist and the funds will be distributed to the beneficiary
- Have the account form part of their **estate** — the TFSA will be distributed according to the terms of the deceased's will

### Successor holder

A TFSA holder may only appoint his or her *survivor* (i.e., the holder's spouse or common-law partner at the time of death) as the successor holder for the account. Typically this designation is made within the TFSA plan document; however, it may also be made by will, provided the will states the successor holder unconditionally acquires all of the deceased holder's rights under the plan including the unconditional right to revoke any beneficiary designation.

The effect of appointing a successor holder is to give continuity to the TFSA. The survivor automatically becomes the holder of the account at the time of the former holder's death, meaning that the TFSA does not come to an end at the moment of death.

### Income tax considerations

From an income tax perspective, there has been no change: any income earned after the death of the holder will continue to accrue on a tax-free basis in the TFSA and the deceased's spouse or common-law partner may make withdrawals from the TFSA free from tax.

As the successor holder has taken over the TFSA, the normal rules regarding contribution room and the combining or consolidating of TFSA accounts will apply. Where the successor holder had their own TFSA, they may choose to consolidate the two plans by the direct transfer of all or part of the assets of the holder's plan to their own plan. In most cases, the direct transfer will not affect the successor holder's TFSA contribution room.

Going forward, the successor holder may make additional contributions to the combined TFSA (or separate TFSAs) based only on their own unused contribution room,

## Excess TFSA amount

Usually, the survivor's contribution room is unaffected by the acquisition of the deceased's TFSA. However, if the deceased had an excess TFSA amount at the time of death, the excess TFSA amount may pass to the survivor. The survivor will be deemed to contribute the entire excess TFSA amount to a TFSA the survivor held at the beginning of the month after the date of death.

## Designated beneficiary

Where there is no successor holder, the TFSA contract may provide for a designated beneficiary or beneficiaries (for example, survivors not named as successor holders, former spouses/common-law partners or children). The person so designated by the TFSA is deemed to have acquired their interest in the TFSA at the time of death for a cost amount equal to its fair market value at that time.

In the event the designated beneficiary is a minor child at the time of the holder's death, a trustee or guardian must be appointed to receive the proceeds from the TFSA.

## Income tax implications

In essence, the fair value at the date of death may be viewed as a non-taxable capital receipt to the designated beneficiary and may be withdrawn free of tax. Any accretion in value after death will be subject to tax in the hands of the designated beneficiary.

There are no special rules permitting a beneficiary (other than a surviving spouse or common-law partner) to contribute funds from the holder's TFSA to their own TFSA, but the funds received can be contributed as long as they have unused TFSA contribution room available.

Where the designated beneficiary is a surviving spouse or common-law partner, subject to certain restrictions, the individual may contribute all or a portion of the funds received from the holder's TFSA to their own TFSA as an exempt contribution without affecting their own unused contribution room. It should be noted that this exempt contribution rule is more restrictive than the rule applicable to successor holders.

In order to do this, the exempt contribution payment must be made before the end of the calendar year following the year of death, the payment may not exceed the fair value of the holder's TFSA at the date of death and the prescribed designation election form must be filed within 30 days after the contribution is made. Where the balance in the TFSA exceeds the fair value at the date of death, the income earned is a taxable receipt.

### **Example: Designated beneficiary is a surviving spouse or common-law partner**

Prior to Sally's death in January 2014, she was living with her common-law partner Tom. Under the terms of the TFSA, Sally had designated Tom as a beneficiary; however, she had not completed the successor holder designation. At the time of Sally's death, the fair value of her TFSA was \$27,000 and an additional \$1,500 of income accrued in the plan prior to the funds being paid to Tom.

Tom may make an exempt contribution of up to \$27,000 to his TFSA, provided the contribution is made

before 1 January 2016 and the required designation is filed within 30 days of making the contribution. The \$1,500 that was earned in the TFSA since Sally's death would be taxable income to Tom. Had Sally made a successor account holder appointment, the entire \$28,500 could be transferred to Tom's TFSA or continue as a separate TFSA.

## Asset of the deceased's estate

Where the TFSA contract does not name a successor holder or designated beneficiary, the property in the TFSA is an asset of the estate and is distributed in accordance with the terms of the deceased's will.

## Income tax implications

Income and accrued capital gains in the TFSA to the date of death are exempt from income tax. The assets of the TFSA form part of the capital of deceased's estate and may be distributed to the beneficiaries in accordance with the terms of the will.

Income accruing after the date of death, including capital gains or losses, is included in the taxable income of the estate and subject to income tax either in the estate return or the hands of the beneficiaries.

## Your next steps

As a starting point, review your TFSA plan documents to determine whether you have appointed your spouse or common-law partner as a "successor account holder" or designated a beneficiary. You may need to speak to your TFSA administrator to confirm this. If your plan was set up in 2009, you may not have appointed a successor account holder.

Decide who you wish to receive the assets in your TFSA following your death. This of course is not a one-time decision, but rather a matter for reflection each time you review your will and estate plan.

Where you decide to leave the TFSA to your spouse or common-law partner, complete the necessary documents to appoint a successor account holder. By doing so, your legacy may continue to grow tax free.

## TFSA primer

- You can contribute up to \$5,500 annually (\$5,000 prior to 2013). If you contribute less than the maximum amount in any year, you can use that unused contribution room in any subsequent year. The cumulative contribution limit for 2014 is \$31,000.
- You can maintain more than one TFSA, as long as your total annual contributions do not exceed your contribution limit.
- Income and capital gains earned in the TFSA are not taxed, even when withdrawn.
- Neither income earned in the TFSA nor withdrawals from it affect your eligibility for federally income-tested benefits (i.e., Old Age Security, the Guaranteed Income Supplement) or credits (i.e., GST/HST credit, age credit and the Canada Child Tax Benefit).
- You can make withdrawals at any time and use them for any purpose without attracting any tax.
- Any funds you withdraw from the TFSA — both the income and capital portions — are added to your contribution room in the next year. This means you can re-contribute all withdrawals in any subsequent year without affecting your allowable annual contributions. Re-contribution in the same year may result in an over-contribution, which would be subject to a penalty tax.
- Permitted investments for TFSAs are similar to those for registered retirement savings plans (RRSPs)

and other registered plans. And, like RRSPs, contributions in kind are permitted. But be aware that any accrued gains on the property transferred to a TFSA will be realized (at the time of transfer) and taxable, while any accrued losses will be denied.

- Gift or loan funds to your spouse or partner so they can make their own contributions. The income earned on these contributions will not be attributed to you while the funds remain in the plan.
  - You can also gift funds to an adult child for TFSA contributions. An individual cannot open a TFSA or contribute to one before the age of 18. However, when you turn 18, you will be permitted to contribute the full TFSA dollar limit for that year.
  - The Canada Revenue Agency (CRA) will track your contribution room and report it to you annually as part of your income tax assessment. If you over-contribute, as with RRSPs, the over-contribution will be subject to a penalty tax of 1% per month while it remains outstanding.
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