

# CHOO'S FINANCIAL INSIGHTS

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## Death Of A TFSA Holder

Most people will have this question: When a TFSA holder dies, what happens to the funds in the account?

Generally, there are 3 options that happen with a TFSA account. The account holder can:

- ◇ Name a **successor holder** who becomes the **account holder** upon his/her death.
- ◇ Designate a beneficiary or beneficiaries who will receive a distribution from the account.
- ◇ Name your estate to receive the distribution. This means proceeds will be distributed based on the terms of the deceased's Will.

*Since its introduction in 2009, the tax-free savings account (TFSA) has become an investment vehicle of choice for millions of Canadians. After introduction, the Department of Finance estimated that at the end of 2011, the value of assets in TFSAs would be more than \$62 billion.*

*This meant that, Individuals, who since 2009 would have made the maximum annual contributions and not withdrawn any funds, would have \$31,000 plus accumulated income in their respective plans.*



## Successor holder

A TFSA holder may only appoint his or her survivor, that is, the holder's spouse or common-law partner at the time of death - as the successor holder for the account. This designation is usually made within the TFSA plan document, but, it may also be made by Will, provided the Will states the successor holder unconditionally acquires all 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 since the successor holder literally takes over the account when the accountholder dies.

The TFSA continues to grow tax-free in the hands of a successor holder and usually the surviving spouse will then consolidate the TFSA with their own TFSA for ease of administration. The spouse can however, maintain the account separately, if they opt to.



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,

## 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). For the beneficiary, the income and gains accrued up to the date of death are also tax-exempt. However, the income and gains earned after the date of death are taxable for the beneficiary. This means, the beneficiary 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.

## Designation of an “exempt contribution” by a surviving spouse or common-law partner designated as the beneficiary of the spouse's TFSA

A surviving spouse or common-law partner designated as the beneficiary of the spouse's TFSA has the option to contribute and designate all or a portion of the payment as an “exempt contribution” to their own TFSA. Doing so has the advantage of not affecting their unused contribution room.

However, the following conditions must be met for a contribution to qualify as an “exempt contribution”:

- An amount paid out directly or indirectly of an arrangement that ceased to be a TFSA upon the death of its holder must be made to the surviving spouse following the holder's death;
- A contribution is made by the surviving spouse to their own TFSA by December 31 of the calendar year that follows the year of death
- The surviving spouse must fill out form RC240, “Designation of an Exempt Contribution Tax-Free Savings Account (TFSA),” and send it to tax authorities within 30 days after the day of the contribution to their own TFSA account
- The amount of the “exempt contribution” must not exceed the fair market value of the TFSA at the time of death.

It's important for the surviving spouse to remember that the time required to file form RC240 is very short, i.e. 30 days after the contribution to the surviving spouse's TFSA, therefore the surviving spouse must make sure the form is filed on time.

## Deceased's unused contribution room

As a reminder, no contributions may be made to a taxpayer's TFSA after their death. Contrary to an RRSP, where the legal representative of the estate is allowed to make a contribution to the surviving spouse's RRSP using the deceased's unused contribution room at the time of death, there is no spousal TFSA, and therefore, any unused contribution room when a TFSA holder dies is lost. However, when death is imminent and a TFSA holder will be leaving a spouse behind, it may be beneficial to take advantage of unused contribution room by contributing the maximum amount to the TFSA before the holder's death. This will increase the surviving spouse's contribution limit when the funds are subsequently transferred to the surviving spouse's own TFSA as an "exempt contribution" or when a spouse has been designated as a successor holder.



## Conclusion

If you have a TFSA or you're planning to open a TFSA I hope this article has answered some of the questions you have.

If you would like to discuss further about this I'm available. Just call or schedule an appointment to meet with me.

Sincerely,

*Ray*

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