

Planning Matters

Beneficiary Designations - How Hard Can it Be?

Five Often Overlooked Aspects of Beneficiary Designations

Beneficiary designated products come in different forms, namely financial products such as Registered Retirement Savings Plans ("RRSPs"), and Tax Free Savings Accounts ("TFSA's"), or insurance products. A beneficiary designation can be made on a form designed by the product's provider or in a Will.

Many people are not as careful about making the proper beneficiary designations as they are when it comes to arranging other aspects of their estate plan, such as their Will or a trust. It seems that some do not understand the consequences of beneficiary designations while others may realize that changes should be made but do not take the correct steps to change them. Nevertheless, beneficiary designations can have serious ramifications on the disposition of assets on death. The following list highlights some, but not all, of beneficiary designations that affect asset transfer on death yet are often overlooked by holders of beneficiary designated plans:

1) The Estate May Pick up the Tab for RRSP Tax

Absent a tax-deferred rollover, the fair market value of the RRSP on the RRSP holder's death is treated as income and must be included in the RRSP holder's terminal return. This means that the RRSP holder's estate must pay the tax on the RRSP, regardless of whether or not the designated beneficiary is the estate. A potential problem arises when, for example, Mr. Smith has an RRSP and designates it to his second spouse, Linda. The

residuary beneficiaries of Mr. Smith's estate are his children from a prior marriage, Jimmy and Anne. Linda does not elect to roll Mr. Smith's RRSP into her own RRSP but instead takes the RRSP for cash value. The value of the RRSP is taxed as income in the terminal return of Mr. Smith. Jimmy and Anne (the residuary beneficiaries of the estate) now bear the burden of paying the tax owing on the RRSP while receiving none of the proceeds.

2) The Latest in Time Designation Applies

Beneficiary designations can be made in a Will. However, the Will does not override subsequent designations. This is because the latest in time beneficiary designation applies. A common problem arises when an individual designates his or her spouse as the insurance policy beneficiary under the Will on a Wednesday and on the Friday acquires a new life insurance policy and designates the estate as the beneficiary on the form provided by the insurer. Many believe that the beneficiary designation in the Will overrides the subsequent designation; however, this is not the case. It is the Friday designation that applies as it was made latest in time. This rule applies not only to insurance but also to all other beneficiary designated products, such as RRSPs and TFSA's.

3) Beneficiary Designated Plans May Offer Creditor Protection

Beneficiary designation products are sometimes used for creditor protection. This is because when a beneficiary is designated on a product, the funds pass to the beneficiary directly outside of the estate. Thus the product's funds are unavailable to creditors of the estate. This is generally effective as it relates to life insurance. However, this creditor protection strategy may not be bulletproof, as it relates to non-insurance products. While the Ontario Court of Appeal in *Amherst Crane Rentals Ltd. v. Perring*, 2004 CanLII 18104 (ON CA) ruled that when a designated beneficiary is named the funds are not available to creditors of the estate, the Manitoba Court of Appeal has ruled that RRSP funds are available to creditors but only after all other assets of the estate are exhausted. This lack of clarity in the law has led to uncertainty as to whether beneficiary designated plans are truly creditor-proof on death. Additionally, not all beneficiary designated products offer the same level of protection as the legislation governing the different products varies.

4) Various Legislation Covers Beneficiary Designated Products

In Alberta, as with most provinces, there is various legislation governing different beneficiary designated products. The *Insurance Act* deals with life insurance. The *Wills and Succession Act* and the *Income Tax Act* cover RRSPs. The *Canada Education Savings Act* and the *Income Tax Act* govern Registered Education Savings Plans ("RESPs"). The *Canada Disability Savings Act* and the *Income Tax Act* deal with Registered Disability Savings Plans ("RDSPs"). As with Will planning, it is recommended that beneficiary designations are reviewed with a lawyer at the same time as the Will is reviewed, every two to five years or when there is a change in circumstances. This will provide assurance that the legislation has not changed in a manner that derails the current planning.

5) A Successor Holder May be Appointed for a TFSA

A Tax Free Savings Account ("TFSA") is an account that does not incur taxes on any contributions, interest earned, dividends or capital gains, and can be withdrawn tax-free. The contributions are not tax-deductible and any unused contributions can be carried forward from year to year. Many people are unaware that appointing a surviving spouse as a successor holder of a TFSA, rather than a beneficiary, is possible. Nevertheless, appointing a successor holder provides additional benefits to the surviving spouse as compared to appointing the surviving spouse as a beneficiary. The surviving spouse as the successor holder can take over the TFSA, retaining its tax-free status, without affecting their own contribution limit. A designated beneficiary of the TFSA, however, would not retain the tax-free status of the TFSA funds upon transfer to the beneficiary. When TFSAs were first introduced in 2009 no beneficiary forms were available. Anyone that opened an account in the initial year should speak with their advisor to update the beneficiary designation or appoint a successor holder.

Contributing Writers:

Barbara Kimmitt,
Barrister & Solicitor
kimmittb@bennettjones.com
403.298.3665

Laura Hoyda,
Barrister & Solicitor
hoydal@bennettjones.com
403.298.3493



Editor:
Patti Shannon, CFA
Vice President, Portfolio Manager

Views expressed are the views of the contributing writer and do not necessarily represent the views of Leith Wheeler, and do not constitute legal or other advice. Leith Wheeler Investment Counsel Ltd. is an employee owned firm providing portfolio management services for individuals, pensions and foundations. Planning Matters is not intended to provide investment advice, recommendations or offers to buy or sell any product or service.