



What Happens to Your TFSA at the Time of Death?

Estate planning options for Tax-Free Savings Accounts

Much has been written about the advantages of a TFSA – the accumulation of tax-free income, the ability to re-contribute withdrawals in a future year, and access to funds without impact to federally sponsored benefits such as Old Age Security (OAS). But, not much has been said about the implications of holding a TFSA at the time of death. Given that many TFSA holders are seniors, it is important to be aware of estate planning options as they relate to the TFSA.

What happens to your TFSA at the time of death?

TFSA legislation allows you to name a “successor holder” who would inherit your TFSA at the time of your death. Your successor holder must be a spouse or common-law partner (CLP). If someone other than a spouse or CLP is to inherit your TFSA, that person would typically be referred to as “beneficiary.” Where a successor holder is designated, your successor holder acquires all rights related to your TFSA at the time of your death. Similar to the “successor annuitant” designation on a Registered Retirement Income Fund (RRIF), your successor holder simply replaces you as holder of your

TFSA, and the plan continues with all rights passing to your successor. Successor holders do not require TFSA contribution room to receive this benefit.

The naming of a successor holder is effective in ensuring that income earned after your death is not taxed. Without a successor holder designation, TFSA legislation requires taxation of income earned in your TFSA after death. Consider the following example:

Allen, a TFSA holder, died with a TFSA valued at \$35,000 at the time of his death. Allen’s spouse, Meg, was not named successor holder, but was entitled to Allen’s TFSA by way of his will. Six months after Allen’s death his TFSA was closed. Between the time of death and the closing of his plan, the TFSA increased by \$2,000. As beneficiary of Allen’s estate, Meg received \$37,000 from Allen’s TFSA, \$2,000 of which was taxable to Meg as ordinary income.

Notice that \$35,000 was received by Meg tax-free. This represents income earned in the TFSA prior to Allen’s death – income that remains tax-free when paid to beneficiaries. However, because a successor holder was not named, the

\$2,000 earned after death became taxable. If Meg had been named successor holder of Allen’s TFSA, she would have replaced him as holder, and the \$2,000 would have been earned tax-free.

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If you do not name a successor holder for your TFSA (typically by way of a designation on your TFSA contract or application), would your heirs require TFSA contribution room to continue to earn tax-free income after your death? It depends. If your spouse or CLP inherits your TFSA (e.g., via your estate by way of will), your spouse or CLP would be known as “survivor” and the value of your plan on the date of your death can be contributed to the survivor’s TFSA without requiring contribution room. This is called an “exempt contribution” and must occur on or before December 31st of the year following your death. Your survivor must also designate the contribution as an exempt contribution on CRA form RC240, Designation of an Exempt Contribution Tax-Free Savings Account (TFSA), and file the form with the CRA within 30 days of the contribution. Amounts earned in your TFSA after death, but before distribution to your survivor, would require TFSA contribution room for future tax sheltering.

Should someone other than your spouse or CLP inherit your TFSA, the tax-free amount earned before death is still passed to beneficiaries tax-free. Amounts earned after death but before distribution are taxable, and TFSA contribution room is required to shelter all amounts from future tax. Only your spouse or CLP is entitled to an exempt contribution. Consider this example:

Of the \$37,000 Meg received, \$35,000 was contributed to her TFSA without impact to her contribution room – the contribution occurred before December 31 of the year following Allen’s death and she designated the contribution on CRA form RC240 within 30 days of the contribution. Also, although she was taxed on the \$2,000 earned in Allen’s TFSA after death, her available contribution room allowed her to contribute this amount to her TFSA, providing for future tax sheltering for the entire amount (\$37,000).

Application designations

When the TFSA was launched in January 2009, there were questions about beneficiary and successor holder designations. Similar to RRSPs and RRIFs, would designations be permitted on TFSA applications, or would the designation have to be made by way of will? While federal TFSA legislation signaled a desire to allow for application designations, updates to provincial and territorial legislation would be required to allow for such a designation.

Since 2009, with the exception of Quebec where will designations continue to be required, all provinces and territories have amended their respective legislations to allow for TFSA application designations. This typically allows TFSA assets to bypass the estate of the deceased and transfer directly to named beneficiaries. With this result, complex estate settlements can typically be avoided and probate fees reduced where applicable. For residents of Quebec, TFSA transfers at death continue to pass through the estate of the deceased and are governed by the terms of the deceased’s will.

This publication should not be construed as legal or tax advice since each client’s situation is different. Please consult your own legal and tax advisors.

