Enhancing the Estate

It is important to keep in mind that the payment of proceeds at death under life insurance policies does not trigger an income tax liability for the estate. The payment of funds under Plans does, unless the beneficiary is a spouse or a dependent child or grandchild, in which case the tax is usually deferred.

A beneficiary designation may not always be the best option. A Policy or Plan payable to the estate is one way to provide for your unpaid taxes and other estate debts that may arise. Additionally, in the event that there is insufficient liquidity in the estate for other liabilities or gifts, a Policy or Plan payable to the estate provides funding without having to sell assets such as real estate.

Designating Minors as Beneficiaries

Minor children may be designated as beneficiaries of Policies or Plans, however a minor is not legally competent to manage property. While a parent of a minor child is automatically the guardian of the child's person, the parent is not the guardian of a minor child's property. Where the value of the gifted funds exceeds the provincial threshold (e.g. $25,000 in Quebec, $10,000 in Ontario), and absent the appointment of a trustee, an arm of the provincial government (e.g. Public Curator, Office of the Children's Lawyer) will be the statutory guardian of the child's property, until the child attains the age of majority.

Typically, a Trustee is named in the Will or other document which designates the child as a beneficiary, to manage the child's funds until age of majority, or beyond. The funds must be received by the appointed Trustee on behalf of the child, and kept invested for the child's benefit. Proper documentation of the creation of a Trust for the benefit of the minor child and under what terms the child is to receive distributions, as part of the designation, is critical. Without a proper Trust document outlining the terms of Trust, there is no ability to access the funds for the child's needs (for example, for sports, camps, orthodontics, music lessons, counseling, education, etc.) other than, in some circumstances, by way of application to court. Furthermore, without terms of Trust there is no authority to hold the funds beyond the age of majority.

Creditor Protection

In most provinces and depending on the circumstances, Policies and Plans which are designated to named beneficiaries (not the estate) are protected from estate creditors. Registered Plans, which are not insurance products, are protected in the context of bankruptcy with the exception of the contributions made to the Plan in the 12 months preceding the date of bankruptcy. In most provinces, insurance products (Plans and Policies) are also protected outside the context of bankruptcy so long as at least one named beneficiary is a spouse, child, parent or grandchild ("creditor protected class") of the owner of the Plan or Policy. With respect to corporately owned Policies and segregated funds that are held in a nominee-registered account, protection from creditors may be lost (this may not apply in Quebec).

Other Considerations

In some provinces divorce nullifies appointments of, and gifts to, a former spouse, made in a Will (this differs in Quebec, depending on the circumstances). However, divorce does not cancel beneficiary designations on Policies and Plans in favour of the former spouse. The designation remains intact and, as a result, the former spouse would be entitled to the proceeds or funds, although that may not have been the intention of the deceased. Where a marriage or common-law relationship ends, clients should be advised to make appropriate changes to any beneficiary designations they may have made, in addition to changing their Wills.

Typically, the last document signed which is a valid beneficiary designation trumps previous designations. The onus is on the owner of the Policy or Plan to inform the insurer or provider of any re-designation. Additionally, with respect to life insurance Policies, beneficiary designations govern only those Policies which exist at the date the designation is made.

Successor Annuitant versus Beneficiary Designation of Registered Plans

Many clients ask what the difference is between a successor annuitant and a designated beneficiary, with respect to registered plans.

A successor annuitant can only be a surviving spouse, and, only with respect to payments from a Registered Retirement Income Fund ("RRIF"). The effect of a successor annuitant appointment is that the funds are NOT rolled over to the RRIF of the surviving spouse. In the case of a successor annuitant appointment, the surviving spouse "takes over" the existing RRIF account of the deceased. The account itself remains the same and no funds are moved out of the deceased's account. The name and SIN are simply changed to that of the surviving spouse. The payments will continue to be calculated on the date of birth of the deceased spouse.

All other types of registered plans (including the RRIF) can be designated, either by Form or Will, by naming a beneficiary who is to receive the entire Plan funds. In this case, the funds in the Plan move out of the deceased's Plan account. Only in the case of a surviving spouse or common-law partner (or a financially dependent child or grandchild – as defined in the Income Tax Act) who elects to fund his/her own RRSP/RRIF plan without cashing out the deceased spouse's Plan, can there be a rollover (tax deferral) of the deceased's Plan. In that case, taxes would be payable on the second death. So, in the case of a designated beneficiary, as opposed to a successor annuitant, the surviving spouse may elect to transfer the assets to his/her own RRSP or RRIF. Estate tax receipts will be issued if this option is elected – T4RIF and a 60(l) off-setting contribution receipt in the name of the surviving spouse. If the funds are rolled over to the surviving spouse (either an RRSP or RRIF) the deceased's RRIF minimum payment (or remainder thereof) must be paid out to the surviving spouse first as the CRA deems it ineligible for rollover. Where the designated beneficiary is not a spouse/common-law partner (or a financially dependent child or grandchild), income tax on the Plan is payable pursuant to the deemed disposition at death.

Seek Professional Advice

Beneficiary designations regarding registered Plans and life insurance Policies can be complicated. There are differences in provincial laws governing how designations are made. Federal and provincial statues, case law and the Civil Code in Quebec determine the nature and extent of creditor protection that applies to a Plan or Policy (or its proceeds), whether during lifetime or after death of the owner. It is critical that you consult with a professional in your jurisdiction before making or changing a beneficiary designation on a Plan or a Policy. It is also important to keep a detailed list of Plans and Policies where beneficiary designations have been made and to review these every few years to ensure that the designations are consistent with your overall estate plan, and that they reflect your current intentions and your current life circumstances.

!

For more information, speak with your BMO financial professional.

BMO Wealth Management

02/20-0214 ID3297