How beneficiaries really work

It can be a good idea to name a beneficiary on your registered accounts, instead of just in a will.

One of the most important financial decisions you will make in your lifetime is who will get the assets in your registered accounts after you pass away. There are plenty of options: from a spouse or a child to your estate or a favourite charity. And while you're not required to name someone, adding a beneficiary or a successor holder to these accounts will ensure the right person eventually gets your assets.

Naming a beneficiary directly on a registered plan or a tax-free savings account (TFSA) form, instead of in a will, has benefits, such as potentially avoiding the probate fees for those assets after you pass away, as well as more explicitly detailing who gets which assets in an account. (Note: Québec does not have a beneficiary option for registered accounts.)

However, naming a beneficiary can also be a bit complex. If you are married or in a common-law relationship, you can name your spouse as either a beneficiary or a successor holder on certain accounts. As well, if you're single versus in a partnership, you may approach the beneficiary process differently.

Fortunately, we've streamlined how the beneficiary process works per account type.

TFSA

If someone other than a spouse is named as the beneficiary: They receive the value of the TFSA at the time of the account holder's death, tax free, and can put that money into their own TFSA or RRSP if they have contribution room. There is one thing to keep in mind: any growth in the account between the date of death and the date of payout is taxable, and it's taxed at the beneficiary's marginal rate.

If a spouse is named as the beneficiary: It's the same as above, but with one key difference—a married or common-law spouse can move the funds into their own TFSA, regardless of whether they have contribution room remaining.

If a spouse is named as the successor holder: A successor holder is different than a beneficiary, in that a successor holder assumes ownership of the TFSA itself rather than receiving funds from the account. There is no requirement to transfer money out of the account. The successor holder's TFSA contribution room is unaffected, and any growth on the account after the date of death is not taxable. When the time is right, whenever that may be, the spouse can transfer the assets from that TFSA into their own TFSA whether they have contribution room or not.

Bottom line: Most married or common–law couples name their partner as a successor holder for the most flexibility.

RRSP

If someone other than a spouse or a dependent child is named as the beneficiary: The person receives the value of the RRSP at the time of the account holder's death. That amount is taxable income in the hands of the deceased's estate. Any growth in the account between the date of death and the date of payout is added to the beneficiary's taxable income.

If a spouse or a dependent child is named as the beneficiary: In most cases, the assets in the deceased person's RRSP would get rolled over into the spouse or child's own RRSP on a tax–deferred basis. The beneficiary would pay income tax on those funds only when they're withdrawn, just like they would when removing any money from an RRSP or a registered retirement income fund (RRIF). A spouse can also receive a cash payout of the RRSP's value at the time of the death, with that amount considered taxable income in either their hands or that of the deceased's estate.

Bottom line: If you're married or living common law, name your partner as a beneficiary so that they can make use of the tax rollover option. If you're not married, and depending on your situation, you may want to name your estate as the beneficiary. Why? Because if you name one person, then they receive the value of the funds, while the estate, which could be distributing assets to other family members, will have to pay the tax bill. Problems could arise if those members receive less because the estate pays tax on the assets another person receives.

RRIF

If someone other than a spouse or a dependent child is named as the beneficiary: The rules are the same for RRIFs as they are for RRSPs, as described above.

If a spouse or a dependent child is named as the beneficiary: Again, see RRSPs above.

If a spouse is named as the successor annuitant: Like with the TFSA's successor holder option, a successor annuitant assumes ownership of, and receives payments from, the deceased's RRIF. The successor annuitant pays taxes on any withdrawals, which must be done according to the schedule originally set out by the deceased.

Bottom line: If your spouse is older than you, it could be beneficial to name them as a successor rather than a beneficiary, as the withdrawal schedule would be based on your (lower) age. This offers them the option to remove funds from RRIF more slowly, since minimum withdrawal amounts increase with age. By implementing this strategy, you may be able to pay less taxes.
