INSIGHTS

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Beneficiary Designations

The importance of accuracy and understanding

What do life insurance policies, RRSPs, RRIFs, pension plans, segregated funds and group insurance plans have in common? They all share the ability to designate a beneficiary who will receive the benefits of the plan or policy after the client's death.

Much has been written over the years about the importance of naming a beneficiary and ensuring that a beneficiary designation, once completed, is reviewed and updated annually. It is especially important to review your beneficiary choice if there have been certain changes in your personal or financial situations; these changes would include: transfer of an RRSP to a RIF, divorce or separation, adoption, death of a spouse/common law spouse or someone mentioned in the beneficiary appointment such as a trustee.

In a May 4, 2004 Ontario Superior Court case, the issue involved who was entitled to the life insurance and assets in the deceased person's RRSP - the designated beneficiary or the Estate. In this case, Mr. and Ms. G. entered into a Separation Agreement in 2004 in which Ms. G. released her entitlement to all assets as part of the settlement of all claims between them. However, Mr. G died before he changed the designated beneficiary on his RRSP and life insurance policies.

The Court determined that Ms. G. was entitled to receive the assets in the RRSP and the life insurance proceeds on the basis that the Separation Agreement did not revoke Ms. G.'s rights as the named beneficiary in both the RRSP and the insurance policy.

There have been other cases where the rights of a named beneficiary have been revoked because of a proven intention of the deceased, but this did not occur in this case. Therefore, if the intention is to have the RRSP and insurance not go to your former spouse, it is important to change the beneficiary.

A poorly designed beneficiary designation form can create more questions than answers. It can deprive a member of rights, create interpretation problems and result in unintended beneficiaries. Unfortunately, improperly drafted forms are all too common. All individual policies, and most retirement and group insurance plans allow members to complete forms that designate beneficiaries to receive benefits payable if members die. These forms can be helpful, enabling benefits that would otherwise be payable to a member's estate to be paid directly to the designated individual. But a poorly designed designation form can be more harmful than helpful.

Here are few examples of problems that I have seen…

Spousal - The form states that if a member has a spouse, that person is automatically selected as the designated beneficiary. But why restrict a member's choice by deeming the spouse as beneficiary? If the plan requires the spouse to receive a joint and survivor pension or other benefit, the designation form is not appropriate. If the spouse is not automatically entitled (due to separation, for example), the member should have the choice of beneficiary.

Multiple Beneficiaries - Another problem results when the form allows the member to designate multiple beneficiaries and to specify the share of each. In these cases, it is unclear how to proceed if one of the named beneficiaries dies before the member.

Contingent Beneficiaries - If young children are named as beneficiaries, the amount may have to be paid into court until they reach the age of majority. Trustees named under the member's will cannot legally receive money on a minor's behalf under a designation form. Nor should it be assumed that an amount payable to a minor beneficiary can legally be paid to the minor's parent. To address this, a beneficiary form should include a section permitting the member to designate a trustee to receive payment for a minor beneficiary. It should specify whether the trustee is permitted to use any of the amount for the minor's benefit. A beneficiary designation form is an important legal document and should be designed and completed with the utmost care and a clear understanding of its effect.

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Beneficiary Designations..., cont'd

A fascinating case (Moxsom v The Queen, 2006 TCC541) decided in October 2006 in Halifax deals with the intricacies of a beneficiary designation made on a pension plan upon the death of a member, along with the potential tax risks associated with failing to make the beneficiary designation properly.

The case involved Cindy Moxsom, who was reassessed for the 2003 tax year with respect to benefits paid to her under her late father's pension plan. The benefits were included in her income. Moxsom acknowledged that the cheques she received from the pension plan administrator were in her name as was the T4A, but she maintained that such amounts were not received by her in a personal capacity.

In April 1997, Mr. Moxsom retired and signed a document entitled 'Appointment of Change of Beneficiary Form' appointing his daughter Cindy as his only beneficiary under his pension plan.

Four years later, Moxsom was hospitalized with lung cancer and 'began worrying about getting his affairs in order'. As a result, in April 2001, he summoned his family to his hospital wherein he completed a document, thought to be a will, but which turned out to be a 'wills questionnaire'.

On May 12, 2001, Moxson passed away, and was survived by his four children: Cindy, Doris, Brenda, and Ronald. Following his death, Sun Life began paying the pension benefits to Cindy, as the sole designated beneficiary.

In 2003, she received nearly $16,000 which she deposited in a bank account established for the estate of her late father. During the year, she disbursed the accumulated benefits, in equal shares to herself and her three siblings, in accordance with her father's wishes, as evidenced by his wills questionnaire.

At the end of the year, Sun Life issued a T4A slip in Cindy's name for the entire pension benefit paid to her. Notwithstanding that it was her name that appeared on the T4A, Cindy reported the pension benefits in her late father's estate return. The Canada Revenue Agency reassessed to include the pension benefits on her return.

Cindy's argument was that her appointment as the sole beneficiary under her father's pension plan was effectively altered when her father signed the 'wills questionnaire' naming her and her siblings as equal beneficiaries of his estate.

The CRA, on the other hand, argued that Cindy's late father never took the necessary steps to give effect to his intention to change the beneficiary designation on the plan from Cindy to his four children.

The judge agreed, finding that "the fact that the appellant shared the pension benefits with her siblings does not alter the fact that the cheques received were issued by Sun Life in her name". The judge added, "the evidence supports the CRA's argument that doing so was a matter of choice, rather than a legal requirement:".

Under the terms of Moxsom's pension plan, a change of beneficiary must be done by written declaration by a 'member' of the plan, which is defined as an employee who has not been terminated nor become a pensioner nor has died.

The judge ruled that because Moxson was no longer a 'member' of the pension plan when he signed the 'wills questionnaire' in April 2001, he was not in a position to legally change his beneficiary designation from his daughter to all four of his children. Accordingly, the judge ruled that the entire amount must be taxed in Cindy Moxsom's hands.

This case emphasizes the importance and significance of beneficiary designations and should be a reminder to us all that our choices should not be made lightly, but when made, they should be reviewed every year to ensure their accuracy.

Until next time…

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Did You Know?

Health Care Expense Account (HCEA) - Bonuses

In a 2005 Advance Income Tax Ruling, CRA ruled that when part of a bonus allocation is credited to the HCEA, this will not be taxable income.

Unused balances in the HCEA at the end of the year may be carried over and used to reimburse eligible medical expenses in a subsequent year. Unused balances will not be payable in cash.

Health Spending Account (HSA)

In a 2006 Advance Income Tax Ruling CRA noted that a company compensates its management employees with a base salary and incentive pay.

The company permits the employee to elect to allocate the incentive pay to an HSA which qualifies as a Private Health Services Plan (PHSP).

CRA ruled that the allocation of credits to the HSA will not be considered taxable income.

Self-Administered Supplementary Unemployment Benefit (SUB) Programs

The basic Employment Insurance (EI) program can be enhanced with an employer top-up plan called Supplementary Unemployment Benefit (SUB) Programs.

Employer payments go on top of the $423/week EI pays, bringing the employee closer to his/her pre-disability earnings.

All plans are registered with HRSDC (Human Resources and Skills Development Canada). Reference material can be found on the HRSDC website.

http://www.hrsdc.gc.ca/en/cs/sub/030.shtml