

Estate Planning for Families with Dependants with Disabilities



A main part of estate planning is ensuring wealth is passed on to dependants in a tax-efficient and effective manner. Families with dependants with disabilities face additional concerns, such as the ongoing care and financial well-being of their loved ones. This article focuses on estate planning strategies for individuals with family members with mental or physical disabilities.

One of the challenges in estate planning for the benefit of family members with disabilities is that leaving assets directly to them may not always be appropriate – for example, children and grandchildren may be too young or may be unable to manage their inheritances due to their disabilities. Even where individuals may be able to manage their inheritances, leaving assets directly to them may impact their eligibility for income and asset-tested government disability support programs.

Government Programs

Each province and territory has its own program to help support people with disabilities. Eligibility for support varies under each program. For example, to qualify for Income Support under the Ontario Disability Support Program (ODSP), applicants must satisfy an income test and an asset test.

In applying these tests there are considerations that should be taken into account. For example, in Ontario, certain incomes, such as payments from a Registered Disability Savings Plan (RDSP) and child support, are exempt for the purposes of determining an applicant's eligibility for ODSP benefits from an income test perspective. The eligibility rules for ODSP also provide exemptions when conducting an asset test (currently limited to \$40,000 for a single person). Assets such as a Registered Education Savings Plan (RESP), RDSP, and trusts derived from an inheritance or proceeds from a life insurance policy up to a limit of \$100,000 are considered exempt for ODSP asset test purposes.

For individuals who would like to provide an inheritance to a disabled family member in their Wills with a view to ensuring the continued financial well-being of their loved one, the challenge is that any inheritance over \$10,000 per any 12 month period will normally be regarded as income at the time of receipt and on an ongoing basis as an asset of the recipient, thus potentially affecting eligibility under the ODSP.

One solution to help maintain ODSP eligibility is to place the assets within a trust. As mentioned above, up to \$100,000 of an inheritance or proceeds from a life

insurance policy may be exempt as an asset if placed in a trust within six months of receipt. However, this may not be an adequate solution if the size of the inheritance surpasses the \$100,000 limit, so other solutions need to be explored.

Possible Estate Planning Strategies

Testamentary Henson Trusts

A strategy adopted since the late 1980s is a Henson Trust. A Henson Trust can be set up as an inter-vivos trust (i.e., during the lifetime of the individual providing support) or testamentary trust (i.e., under the supporting individual's Will). However, this article focuses on **testamentary** Henson Trusts.

The core of this strategy is to set up an absolute discretionary trust in the Will. It is crucial that the language is clear that the income and capital of the trust is to be distributed to the beneficiary only when the trustees decide to do so. The trustees have absolute discretion and full control as to when, if and how much income is to be paid to the beneficiary. In other words, the beneficiary has no vested right to income or capital under the trust and cannot demand payment or distributions from the trust.

The logic of this strategy is predicated on the fact that the beneficiary does not own the trust assets. Therefore, assets held in a Henson Trust will not be counted for the purpose of determining eligibility for government disability support benefits.

Important Considerations when using a Henson Trust

1. Check the provincial and territorial rules

Since eligibility to provincial and territorial disability support benefits depends entirely on provincial and territorial legislation, it is important to determine whether the use of a Henson trust will preserve eligibility in the province or territory of residence.

2. Careful drafting of the Will is necessary

The language in the Will must make it clear that the trustees have no obligation to make payments from the trust for the beneficiary. To ensure that the trust

provisions in the Will are well-drafted, select a lawyer who is familiar with Henson Trusts.

3. Choice of trustees

The essence of the Henson Trust is to confer absolute discretion to the trustees. Therefore, it is important to choose trustees who will respect your wishes and act in the best interests of your beneficiary.

In addition, the following considerations are relevant when deciding who to appoint as trustees:

- Financial acumen – to ensure the trust funds are properly invested and managed.
- Age, health and location – Since the trust generally continues for the lifetime of the beneficiary, the trustees should be available to act throughout that period. It may be necessary to appoint more than one trustee and alternate trustees to ensure continuity.
- Potential conflicts of interest – Other family members may be appointed as trustees as well as being named as residual beneficiaries of the trust, such as a beneficiary’s siblings (see “Choice of beneficiaries” below). This may introduce potential conflicts of interest where the trustees try to retain the funds in the trust rather than expend them for the benefit of the beneficiary. One way to avoid this is the use of corporate trustees.

4. Choice of beneficiaries

A dependant family member is often not the sole beneficiary of the Henson Trust. For legal and practical reasons, Henson Trusts often include additional beneficiaries, such as other family members (e.g. siblings) and charities. The other beneficiaries are usually only able to benefit from the trust in certain circumstances, such as after the death of the dependant family member. Multiple beneficiaries may introduce certain drawbacks. For example, the trustees

will now be faced with duties to more than one beneficiary and the administration of the trust becomes slightly more complicated.

5. Observation of provincial and territorial disability income rules

Recall that there are both asset and income thresholds under government disability support programs. Trustees should be mindful of those thresholds when distributing funds from a Henson Trust to a beneficiary as excessive distributions may jeopardize the individual’s entitlement to government disability support benefits. However, trustees should also consider whether maintaining eligibility to such benefits is beneficial in the beneficiary’s circumstances. For example, depending on the value of the Henson Trust and the beneficiary’s needs, it may be possible to increase their standard of living by making larger distributions from the Henson Trust and forgoing government disability support benefits.

Registered Disability Savings Plan (RDSP)

With the introduction of RDSPs in 2008, individuals engaged in estate planning for a family member with a disability now have another powerful solution. The RDSP encourages long-term savings by families and friends of the disabled dependant through tax and financial incentives. It is also excluded from determining eligibility for Federal and most provincial and territorial asset and income tested disability benefits.

For detailed information as to how RDSPs work, please refer to our article “Registered Disability Savings Plan (RDSP)”.

The table that follows compares various features of the testamentary Henson Trusts and RDSPs. Each has its own benefits and drawbacks. The decision to take advantage of either or both should be made based on your particular circumstances.

Comparison between Henson Trusts and RDSPs

	Testamentary Henson Trusts	RDSPs
Who may contribute	Contribution by anyone under his or her Will.	Contribution by anyone with the written consent of the plan holder.
Contribution limit	None.	\$200,000 lifetime limit.
Who can be a beneficiary	Anyone can be a beneficiary. May have multiple beneficiaries.	Beneficiary must be eligible for the federal disability tax credit, be a Canadian resident, have a valid Social Insurance Number and be under the age of 60. Only one beneficiary per RDSP. Also, only one RDSP can be established for an individual.
Who can be a plan holder	Not relevant to Henson Trusts.	Depends on the age of the beneficiary and/or whether the beneficiary is or may be contractually competent to open a RDSP. Depending on the circumstances, one of the following persons might be able to open a RDSP for the beneficiary: the beneficiary, a legal parent or guardian/tutor/curator of the beneficiary, the beneficiary's spouse (including common-law partner), or a public department, agency, or institution that is legally authorized to act for the beneficiary.
Control over assets	Full discretion is given to the trustees. The beneficiary has no control at all over the trust assets.	The plan holder of the RDSP has the decision-making power. Where the beneficiary is the plan holder, he or she will have control over the RDSP assets.
Additional governmental financial incentives	None.	RDSP contributions attract Canada Disability Savings Grants (CDSG) at matching rates of 100%, 200% or 300% depending on the beneficiary's adjusted net family income, up to a maximum of \$3,500 in a given year and up to maximum lifetime limit of \$70,000. CDSGs are payable until the end of the year in which the beneficiary turns 49. For beneficiaries with low adjusted net family income, further government assistance is provided in the form of a Canada Disability Savings Bond (CDSB). A CDSB is payable each year up to a maximum of \$1,000 and up to a maximum lifetime limit of \$20,000. A CDSB is payable regardless of whether any contributions have been made to the RDSP.

Comparison between Henson Trusts and RDSPs (...continued)

	Testamentary Henson Trusts	RDSPs
Tax treatment	<p>The trust is taxed as a separate taxpayer and files its own tax return each year.</p> <p>Income earned within a testamentary trust and not paid out in the year to a beneficiary is taxed at the highest marginal tax rate or at graduated marginal tax rates if the trust qualifies as a Qualified Disability Trust (different rules apply if a preferred beneficiary election has been made, which is discussed below).</p> <p>Income earned within a testamentary trust and paid to a beneficiary in the year it is earned is generally included in the beneficiary's income and taxed at his or her graduated marginal tax rates.</p>	<p>Contributions are not tax-deductible. Investments in the RDSP grow tax-free.</p> <p>Contributions can be withdrawn tax-free.</p> <p>All other withdrawals are included in the beneficiary's income and taxed at his or her graduated marginal tax rates.</p>
Limits on Withdrawal	<p>None, subject to the trustees exercising their discretion to distribute funds from the trust. The trustees need to be mindful of income and asset thresholds under provincial and territorial legislation so that they do not jeopardize eligibility for provincial and territorial disability benefit programs.</p>	<p>Early withdrawals may result in a repayment of all or a portion of CDSGs and CDSBs.</p> <p>Withdrawals must begin no later than the end of the year the beneficiary turns 60.</p> <p>There is a yearly maximum the beneficiary can withdraw based on a formula set out in the <i>Income Tax Act</i>.</p>
Effect on federal and provincial and territorial government disability benefit programs	<p>Trust assets may be considered exempt assets for the purpose of the eligibility asset test, depending on provincial and territorial rules.</p> <p>Trust income that is accumulated in the trust may be considered an exempt asset and exempt as income for the purpose of the income and eligibility asset tests, depending on provincial and territorial rules.</p> <p>Income distributed from the trust may be considered income of the beneficiary, depending on provincial and territorial rules. Certain types of payments may be considered exempt income. Payments not exceeding prescribed thresholds may also be exempt.</p>	<p>RDSPs are fully exempted from any asset and income tests for eligibility of federal disability benefits.</p> <p>Most provinces and territories have also agreed that RDSPs will be fully exempt from any asset and income tests for eligibility of provincial and territorial disability benefits.</p>
What happens to funds left in the account at the death of the disabled beneficiary?	<p>Assets remaining in the trust at the death of the beneficiary will be distributed in accordance with the terms of the Will establishing the trust; for example, contingent beneficiaries may be named.</p>	<p>Any funds remaining in the RDSP (after required repayment of CDSGs and CDSBs, government grants and bonds received during the preceding 10 years) will be paid to the beneficiary's estate and dealt with under the terms of his or her Will. If the beneficiary does not have a Will, the funds will be distributed in accordance with the intestacy laws of the relevant province or territory.</p>

Possible Tax Planning Strategies

Rollover of Deceased's RRSP/RRIF Proceeds to a Child's RDSP

To provide more flexibility to individuals who wish to provide for a child or grandchild who is financially dependent because of an impairment in physical or mental functions, the *Income Tax Act (ITA)* allows for a tax-free transfer (i.e., a rollover) of a deceased's RRSP/RRIF to an RDSP for the child or grandchild. The amount that may be rolled over is limited to the child or grandchild's available RDSP contribution room. The lifetime RDSP contribution limit is \$200,000. The transferred amount:

- will not attract CDSGs, and
- will be included in the child or grandchild's income when withdrawn from the RDSP.

To take advantage of the tax-free rollover, the child or grandchild or his or her legal representative must make an election in prescribed form at the time of the RDSP contribution.

Possible Estate Planning Strategies

Rollover of Deceased's RRSP/RRIF Proceeds to a Spouse/Child's RRSP/RRIF

The *ITA* also allows for a tax-free rollover of a deceased's RRSP/RRIF to a spouse or child/grandchild's RRSP/RRIF where the child or grandchild was financially dependent on the deceased due to physical or mental infirmity. The spouse or child/grandchild will be taxed at his or her marginal tax rate on any funds withdrawn from his or her RRSP/RRIF.

This approach could jeopardize the dependant family member's entitlement to government disability support benefits due to the asset test discussed above. Unlike

RDSPs, RRSPs and RRIFs are generally not considered exempt assets for disability support benefits. In addition, this approach may not be appropriate where the family member is incapable of managing property and does not have a power of attorney dealing with property. In some cases, it may be possible to avoid these potential issues and still obtain a rollover of the deceased's RRSP/RRIF by using a "lifetime benefit trust".

Rollover of Deceased's RRSP/RRIF Proceeds to a Lifetime Benefit Trust

A tax-free rollover is also available where a deceased's RRSP/RRIF is used to purchase a qualifying trust annuity under which a lifetime benefit trust is the annuitant. The lifetime benefit trust (LBT) would be established under the terms of the deceased's Will.

To qualify as a LBT, the spouse or child/grandchild must have been dependent of the deceased due to mental infirmity. Unlike the abovementioned rollovers, this rollover is not available where the beneficiary has a physical infirmity. In addition, no person other than the spouse or child/grandchild may receive any income or capital from the trust during their lifetime and the trustees must be empowered to pay income and capital from the trust. In determining whether to pay income or capital to the spouse or child/grandchild, the trustees are required to consider their needs. Depending on the terms of a Henson Trust, it may or may not qualify as a LBT.

A qualifying trust annuity is an annuity that meets certain conditions, including the following: it was acquired after 2005, the LBT is the annuitant, and it is for the life of the beneficiary or for a fixed term equal to 90 years minus the age of the spouse, child or grandchild at the time the annuity is acquired.

The tax treatment of a LBT and the spouse, child or grandchild would be similar to the tax treatment of a testamentary Henson Trust, as discussed above.

Qualified Disability Trust

A testamentary trust, including a testamentary Henson Trust, is taxable at the highest marginal tax rate on any income earned in the trust that is not paid to a beneficiary in the year. If the income is paid to a beneficiary, the beneficiary is instead taxable on the income at his or her graduated tax rates. Unless the beneficiary is already taxed at the highest marginal tax rate, paying income to the beneficiary generally results in a lower amount of tax being payable.

Where the beneficiary is a family member with disabilities, it may not be appropriate to pay all the income earned in the trust to the beneficiary each year. For instance, the distribution could potentially jeopardize the beneficiary's entitlement to disability support benefits. If the trustees decide not to pay any income to the beneficiary in the year, the income will generally be subject to a higher rate of tax. However, if the trust qualifies as a Qualified Disability Trust (QDT), the income would instead be taxable at graduated tax rates. In turn, trustees may be indifferent from a tax perspective as to whether income is paid or not paid to the beneficiary in the year.

To qualify as a QDT the following conditions must be met:

- The electing beneficiary must be eligible for the federal disability tax credit (note that not every person who receives provincial or territorial disability support benefits will necessarily qualify for the federal disability tax credit);
- The electing beneficiary must have been specifically named as the beneficiary in the document establishing the trust, such as the Will.;
- The election must include the electing beneficiary's social insurance number;
- The electing beneficiary must not make a QDT election with respect to any other trust;
- The trust must be a testamentary trust;
- The trust is not subject to the federal recovery tax for the year; and
- The trust must be resident in Canada throughout the year.

A trust can be both a Henson Trust and a QDT, but it is not necessary for the trust to be a Henson Trust.

Preferred Beneficiary Election

Where a preferred beneficiary election is made, all or some of the income earned in a trust and retained in the trust is taxed in the hands of the beneficiary. This strategy is beneficial where the beneficiary's marginal tax rate is lower than the trust's marginal tax rate. This might be the case where a Henson Trust is established for the beneficiary and the Henson Trust does not qualify as a QDT. Before making a preferred beneficiary election, consideration should be given to how the election may affect government disability support benefits.

To qualify as a preferred beneficiary the following conditions must be met:

- The beneficiary must be resident in Canada;
- The beneficiary must qualify for the federal disability tax credit, or must be an adult who is dependent due to physical or mental infirmity and has income that does not exceed the federal basic personal amount for that year; and
- The beneficiary must be the person who established the trust (i.e., the settlor) or the settlor's spouse (or former spouse), a child/grandchild/great grandchild of the settlor or a spouse (but not a former spouse) of a child/grandchild/great grandchild of the settlor.

Considerations

There are several options available to consider when estate planning for an individual who wishes to provide financial benefits for a loved one with disabilities. As the various strategies can be complex, you should speak with your tax and legal advisors on this aspect of estate planning to be certain that the most appropriate strategies are implemented.



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