

Estate Planning for Families with Dependents with Disabilities

For many people, part of financial planning is ensuring that they have sufficient financial resources for a comfortable retirement. Families with children who are disabled face additional concerns - the ongoing care and well-being of their children, especially when the parents are no longer able to look after them. This article focuses on estate planning strategies for parents with children who are mentally or physically disabled.

The Challenge

The main challenge in estate planning for the benefit of dependants who are disabled is that leaving assets directly to the dependants may impact their eligibility for income and / or asset-tested government programs.

As an example, to qualify for Income Support under the Ontario Disability Support Program (ODSP), the applicant's financial eligibility is determined by both an income test and an asset test. However, 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), are exempt for the purposes of determining an individual's eligibility for ODSP benefits from an income test perspective. The eligibility rules for ODSP also provide exemptions when conducting an asset test. For example, assets such as registered education savings plans (RESPs), RDSPs, and trust funds derived from an inheritance or an insurance policy up to a limit of \$100,000 are considered exempt for ODSP asset test purposes; so planning around these rules is key.

For parents who would like to provide an inheritance to a child in their Wills, with a view to ensuring the continued financial well-being of that child, the challenge is that an inheritance will normally be regarded as income at the time of receipt and on an ongoing basis as an asset of the recipient.

One solution is to place the assets within an "Inheritance Trust", as there are typically provisions in provincial legislation to exempt trust assets up to a certain limit. In Ontario, for instance, up to \$100,000 of an inheritance may be exempt as an asset if placed in a trust within 6 months of receipt.

The inheritance trust will 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

(A) Testamentary Henson Trusts

A strategy adopted since 1986 is the Henson Trust.

Note: A Henson trust can be set up as an inter vivos trust (i.e. during the lifetime of the contributor) as well; however, we will limit the discussion in this article to the testamentary trust (i.e. created in the Will).

The core of this strategy is to set up an absolute discretionary trust in the Will. It's 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 distribution from the trust.

The logic of this strategy is predicated on the fact that the beneficiary does not own the trust assets. Therefore, those assets will not be counted for the purpose of determining eligibility for governmental programs.



Important Considerations when using a Henson Trust:

1) Check the provincial rules:

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

In Alberta, for instance, the Henson trust is not a viable option because, for the purpose of the disability income program, the definition of an asset encompasses an interest in a discretionary trust.

2) Careful drafting of the Will is necessary:

The language in the Will must make it unequivocally clear that the trustee has 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 formal trusts and specifically the Henson decision.

3) Choice of trustee:

The essence of the Henson trust is to confer absolute discretion to the trustees; so it is important to choose trustees you know will respect your wishes and act in the best interest of the beneficiary.

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

- Financial acumen – so the trust funds are properly invested and managed.
- Age, health and location – Since the trust is to continue for the lifetime of the beneficiary, the trustee should be available to act throughout that period. It may be necessary to appoint more than one trustee to ensure continuity.
- Potential conflicts of interest – Siblings of the beneficiary are often appointed as trustees as well as being residual beneficiaries of the trust (see *Choice of beneficiary(ies)* 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 beneficiary(ies):

Case law suggests that the court will be more likely to consider a person who is the sole beneficiary of the trust as de facto owner of the trust assets. As a result, it has been suggested that a discretionary trust with several beneficiaries (including the child with a disability) may be more appropriate to ensure

continued entitlement to government benefits in that it is much more difficult to imply sole ownership under such circumstance.

This may however introduce drawbacks of its own: the trustees will now be faced with duties to more than one beneficiary; and trust administration becomes that much more complicated.

5) Observation of provincial disability income rules:

Recall that there are both asset and income thresholds under provincial disability benefit programs. Once the trustees of a Henson trust have exercised their discretion to distribute assets to the disabled beneficiary, the funds will be subject to the income rules.

Again, the rules are complex and the provincial legislation should be referred to.

As an example, the 2009 ODSP allows an income support recipient to receive up to \$6,000 in a 12-month period as exempt income, but certain incomes such as payment for a disability-related item or service that has been approved in advance, are considered exempt and do not count against the \$6,000 limit.

(B) Registered Disability Savings Plan

With the introduction of the Registered Disability Savings Plan (RDSP) in 2008, parents engaged in estate planning for their child with a disability now have another powerful solution.

The RDSP encourages long-term savings by families and friends of the disabled individual through tax and financial incentives. It is also excluded from determining eligibility for Federal and most provincial asset and income tested disability benefits.

For detailed information as to how the RDSP works, please refer to our article "Registered Disability Savings Plan (RDSP)"

The table that follows compares various features of the testamentary Henson trust and the RDSP.

The Henson trust and RDSP each has its benefits and drawbacks. The decision to take advantage of either vehicle or a combination of both should be made based on individual circumstances.

Comparison between Henson Trust and RDSP

	Testamentary Henson Trust	RDSP
Who may contribute	Contribution by the testator only.	Anyone may contribute with the written consent of the plan holder.
Contribution limit	None.	\$200,000 lifetime limit.
Who can be a beneficiary	<ul style="list-style-type: none"> Eligibility for the disability tax credit (DTC) is not a requirement. Multiple beneficiaries possible. For instance, can include siblings of the beneficiary with a disability. 	<ul style="list-style-type: none"> Beneficiary must be eligible for the DTC, be a Canadian resident, have a valid Social Insurance Number and be under the age of 60. Only one beneficiary per RDSP, i.e. the disabled individual. Also, only one RDSP can be established for a 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 / she will have control over the RDSP assets.
Additional governmental financial incentives	None.	<ul style="list-style-type: none"> RDSP contributions attract Canada Disability Savings Grants (CDSGs) at matching rates of 100%, 200% or 300% depending on net family income, up to a maximum lifetime limit of \$70,000. For lower income families, further government assistance is provided in the form of Canada Disability Savings Bonds (CDSBs) up to a maximum lifetime limit of \$20,000.
Tax treatment	<ul style="list-style-type: none"> The trust is taxed as a separate taxpayer and files its own tax return each year. Income within a testamentary trust is taxed at the graduated marginal tax rates. 	<ul style="list-style-type: none"> Contributions are not tax-deductible, but plan investments grow tax-free until withdrawn. When paid out of the plan, the CDSG, CDSB and investment income earned are included in the beneficiary's income for tax purposes.



Limits on Withdrawal	None, but trustees need to be mindful of income thresholds under provincial legislation so that they do not jeopardize eligibility for provincial disability benefit programs.	<ul style="list-style-type: none"> • Early withdrawal may result in repayment of government grants. • Withdrawals must begin no later than the end of the year the beneficiary turns 60. • There is a yearly maximum the beneficiary can withdraw based on a formula set by CRA.
Effect on federal and provincial government disability benefit programs	<ul style="list-style-type: none"> • Trust assets may be considered exempt assets for the purpose of the eligibility test, depending on provincial rules. • Income distributed from the trust will be considered income of the beneficiary. Certain types of payments may be considered exempt income. Payments not exceeding prescribed thresholds may also be exempt. 	<ul style="list-style-type: none"> • RDSP is fully exempted from any asset and income tests for eligibility of federal disability benefits. • Most provinces and territories have also agreed that RDSPs will be fully exempt from any asset and income tests for eligibility of provincial disability benefits.
What happens to funds left in the account at the death of the disabled beneficiary?	Assets remaining in the trust at the death of the beneficiary will be distributed in accordance with the provisions of the Will establishing the trust; for example, contingent beneficiaries may be named.	Any funds remaining in the RDSP (after required repayment of government grants and bonds) will be paid to the beneficiary's estate.

Rollover of deceased's RSP/RIF proceeds to an RDSP

As part of the estate planning process, it is also important to mention the changes contained in the 2010 federal budget which allows more flexibility to parents and grandparents when providing for their disabled (grand)children's long-term financial security. As of March 4, 2010, a financially dependent child or grandchild who is dependant because of a physical or mental infirmity may also rollover RIF proceeds, on a tax-deferred basis, to a RDSP.

The amount that may be rolled over is limited to the beneficiary's available RDSP contribution room. The lifetime RDSP contribution limit is \$200,000. The transferred amount:

- will not attract the Canada Disability Savings Grant (CDSG), and
- will form part of the taxable portion of the disability assistance payments (i.e. will be included in the beneficiary's income when withdrawn from the RDSP).

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

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