



Estate Planning for Beneficiaries with Disabilities

Introduction

An important purpose of estate planning is to sure that loved ones are financially cared for after a person's passing. This goal can become more important, as well as more complex, when one or more beneficiaries has special needs which require particular financial planning and protection. A lack of proper planning may lead to mismanagement of the inherited assets, barriers to accessing the assets or a loss of government disability support benefits upon receipt of the inheritance.

While each situation is unique, there are some common estate planning tools which can be used to provide for beneficiaries with disabilities.

Considerations

There are many different factors that need to be taken into consideration when planning for a beneficiary with a disability. First, will there be sufficient assets available to provide for the beneficiary? The answer to this question requires an understanding the net estate size, and of the amount that the beneficiary is likely to receive. Ensuring that assets left to the beneficiary are well invested and that taxes are minimized is also important. Finally, we will want to ensure that the beneficiary's receipt of their inheritance does not interfere with other benefits, such as provincial government disability credits which may be based on asset and income thresholds.

Another concern is making sure that the assets are protected and well managed. If a beneficiary's disability interferes with their ability to manage finances, any outright gift is likely to be quickly lost. The beneficiary may also be vulnerable to financial predators. Therefore, the estate plan should include one or more legal structures which provide protection to and effective management over the inherited assets.

Financial Planning and Insurance

Clients may wish to work with a financial planner to estimate the amount of financial support that the disabled beneficiary will need and how much can or should be left to them through the estate. If the estate is too small to provide adequately for the beneficiary, or there are competing estate wishes or obligations, additional steps might be taken to adjust the financial picture. One option may be to put temporary or permanent insurance in place to increase the size of the estate.

Trusts

Trusts are excellent, and often used, tools in estate planning and are particularly beneficial when planning for beneficiaries with disabilities. A trust is a legal structure, whereby a person or entity, called the "trustee", controls the assets that are placed in the trust. The 'beneficiary' is the person who is entitled to benefit from the assets and the trustee must manage the assets in the beneficiary's best interests. The trust terms may permit the trustee to decide how much money to pay out to or for the beneficiary, and when, or may include provisions to restrict this decision-making.

If the trust is only intended to come into effect after a person's death, then the terms of the trust will be decided and written out during the estate planning process, but the trust will only be funded after death. This is called a testamentary trust. A trust that is both established and funded during a person's lifetime is called an inter vivos trust. Inter vivos trusts are less commonly, but still occasionally, used in estate planning. Generally, a person's will sets out the trust and its terms; a separate trust document might also be drafted.

Henson Trust

A Henson trust is a fully discretionary trust, which permits the trustee to decide how much financial support should be provided to the beneficiary at any given time. These trusts are typically established for beneficiaries who are, or may be, in receipt of government disability benefits that rely on certain income and asset thresholds. In many provinces, assets held in a Henson trust will not be considered assets owned by the beneficiary, and will therefore not interfere with any asset thresholds required to maintain government disability benefits.

It is important to understand that it is not the mere fact of establishing a Henson trust, but rather the way in which it is managed, that preserves need-based disability benefits. Any funds paid out of the Henson trust will be included as income for income-related thresholds for government disability benefits. In Ontario, for example individuals may receive up to \$10,000 annually in total funds – from the trust or otherwise – before Ontario Disability Support Program benefits risk clawback. Payments made for specific disability-related expenses may also be excluded for income. The effectiveness and usefulness of a Henson trust will depend on the specific disability-related legislation in any given province or territory.

Unfortunately, any income earned in the trust and not paid out in a particular year will be taxed at the highest marginal rate, unless the Henson trust also qualifies as a qualifying disability trust or is able to make a preferred beneficiary election. These two specific planning tools are discussed further below. An experienced investment advisor can assist in ensuring that the trust's funds are invested in a way that minimizes taxes on an annual basis.

Qualifying Disability Trust

A qualifying disability trust (QDT) is a testamentary trust set up for a beneficiary with a disability who is eligible for the disability tax credit. Qualifying disability trusts are specially recognized under the Income Tax Act and, unlike most other trusts, are taxed at a graduated rate. This potentially provides significant tax savings compared to other trusts. However, a trust will only qualify as a QDT if:

- It arose on and as a consequence of the death of an individual;
- The trust is resident in Canada (generally, this requires the trustee(s) to be Canadian residents);
- The beneficiary of the trust is specifically named in the will (e.g. a will that gifts the estate “equally to my children” will not suffice);
- The beneficiary qualifies for the disability tax credit;
- The trustee and beneficiary jointly elect for the trust to be a QDT; and
- The beneficiary has not elected for any other trust to be a QDT.

The last requirement restricts an individual to being the beneficiary of only one QDT. Therefore, if multiple family members create multiple testamentary trusts for a beneficiary with a disability, only one can qualify as a QDT and thereby have access to the graduated tax rate.

As long as the above criteria are met, there are no restrictions on the trust terms itself. Therefore, a trust set up as a Henson trust or a lifetime benefit trust may also qualify as a QDT.

[Note: If we don't want to go into detail, could substitute the highlighted section with: However, there are very specific requirements that a trust must follow for it to be considered a QDT. That being said, as long as those requirements are met, a Henson trust or lifetime benefit trust could also qualify as a QDT and obtain access to graduated tax rates.]

Lifetime Benefit Trust

A lifetime benefit trust (LBT) is a testamentary trust that can be set up for a child, spouse, or grandchild who is financially dependent on the testator because of mental infirmity.

The primary benefit of a LBT is that the deceased's RRSP or RRIF account assets can be rolled over into the trust on a tax-free basis. Ordinarily, when an individual passes away, their RRSP or RRIF funds are fully taxable as income in the year of death. Therefore, the ability to rollover these funds into a LBT on a tax-free basis provides significant tax savings, and ultimately increased financial support to the beneficiary.

Once the funds have been placed in the LBT, they must be used to purchase a qualifying annuity, with the trust as the annuitant and the disabled individual as the beneficiary. No one other than the disabled individual may benefit from the trust during that individual's lifetime. While the annuity payments must be made to the trust, the trustee can have discretion as to the amounts paid to or for the benefit of the disabled beneficiary. In this way, the LBT can also function like a Henson trust in protecting government disability benefits. In the right circumstances, the LBT can also qualify as a QDT, combining the primary benefits of all three trusts:

- The tax-free rollover of an RRSP/RRIF account
- The graduated tax rate of a QDT
- The preservation of government disability benefits permitted by a Henson trust

Preferred Beneficiary Election

In some situations, a trust may be able to make use of the preferred beneficiary election to reduce taxes payable. A "preferred beneficiary" is a beneficiary of a trust who either (1) qualifies for the disability tax credit or (2) is over 18, financially dependent on someone else because of a physical or mental infirmity and has income not exceeding the basic personal exemption amount. To qualify as a preferred beneficiary, the individual must also have a specific type of relationship to the creator of the trust, such as a child or a spouse.

If a preferred beneficiary election is made, then income and gains earned in the trust can be taxed in the hands of the preferred beneficiary even if not paid out to the beneficiary. This can be a particularly useful tax planning tool if the trust does not qualify as a QDT.

Choosing the Right Trustee

Regardless of the trust structure used, choosing the right trustee is an integral part of proper estate planning for beneficiaries with disabilities. The chosen trustee must be knowledgeable about the legal and tax requirements concerning the trust, and must be sophisticated enough to work with the beneficiary and other important third parties in order to protect the beneficiary's best interests. The trustee should also be impartial and objective, so as to ensure that their interests do not interfere with their duty to manage of the trust in the beneficiary's best interests. Finally, given that the trust is likely to last for many years, the trustee should be an individual or entity that will survive the lifetime of the trust. As with any other complex trust or estate situations, consideration should be given to naming a corporate trustee to manage the trust assets.

RDSP

An individual who has a disability may be permitted to open a registered disability savings plan (RDSP) account. This is a savings account meant to assist individuals with disabilities in saving for retirement. Contributions made to the RDSP may be matched with government grants and bonds. As well, the investments held in these accounts grow tax-deferred until they are withdrawn by the beneficiary. Another significant benefit of RDSP accounts is that assets in and withdrawals from the account may be partially or fully excluded from needs-based government support benefits threshold tests.

In order to qualify for an RDSP account, a person must:

- Be eligible for the disability tax credit;
- Have a valid social insurance number;
- Be a Canadian residence; and
- Be under the age of 60.

A parent may wish to set up an RDSP account for a child with a disability as an additional means of providing long-term financial support. As well, in the right circumstances, a beneficiary with a disability may be able to direct some or all of a received inheritance into an RDSP account. This can be particularly advantageous if the individual receives an inheritance from an RRSP, RRIF or RPP account held by the individual's parent or grandparent on whom they were financially dependent. In such circumstances, the registered funds can be rolled over into the RDSP account on a tax-deferred basis.

There are some restrictions on RDSP accounts. First, there is a lifetime contribution limit of \$200,000. Contributions may only be made up to age 59, and withdrawals must begin at age 60. Fund withdrawn earlier than age 60 may result in the repayment of government grants and bonds. One major concern in respect of RDSP accounts is that they are legally owned and controlled by the disabled beneficiary. This may not be appropriate if the beneficiary, while legally capable of managing their own finances, is not fiscally responsible, or is vulnerable to third party influences. If the beneficiary is not legally capable of managing their finances, a guardian or attorney for property should be put in place in order to manage the RDSP account, among any other assets that the beneficiary personally owns.

Other considerations

Occasionally, even where a beneficiary suffers from a disability, it may be appropriate to make outright gifts to the beneficiary. This may be the case where the disability does not affect the beneficiary's ability to manage finances and where there is no possibility that the beneficiary will be in receipt of needs-based government disability benefits. In such circumstances, outright gifts can be made through the will, beneficiary designations, and sometimes through joint ownership. It is extremely important to work with an estate and trust professional who can review the entire situation and make customized suggestions for the overall estate structure.

Estate planning for a beneficiary with a disability may extend beyond the effective transfer of assets on death. Often, parents or spouses play an important role in assisting such beneficiaries with daily management of finances and personal needs. Care should be given to ensure that there is a plan in place to ensure that this role can be fulfilled by another person or organization when the primary caregiver is no longer available. For example, the beneficiary should appoint attorneys for property and for personal care. If the beneficiary lacks the mental capacity necessary to make these appointments, a guardianship order may be appropriate.

Conclusion

Crafting a proper estate plan to adequately provide for beneficiaries with disabilities is a complex matter and should not follow one cookie cutter solution. Working with a knowledgeable estate and trust professional such as a Solus Trust advisor can ensure that loved ones are properly cared for after a death.



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