Special arrangements

Elena Hoffstein and Rachel Blumenfeld on planning for persons with special needs

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A family with a disabled family member will likely face heavy financial commitments for potentially a long period of time, whether the disabled person is a spouse, a child, a parent or a sibling. In recent years, the Canadian government has provided increasing support to disabled persons, their families and caregivers through the *Income Tax Act (Canada)* (the Act). In these uneasy economic times, it is important to be aware of these provisions to ease the financial burden. In this article, we will review some of those benefits including the Disability Tax Credit (DTC), Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Funds (RRIF) rollovers and the recently introduced Registered Disability Savings Plan (RDSP).

Disability Tax Credit

The DTC is available in respect of individuals who have a prolonged (over 12 months), severe, mental or physical impairment that affects daily living in some way – walking, hearing, dressing and the like (Subsection 118.3(1) of the Act). If a person has such a disability and the appropriate forms (Form T2201) and approvals are requested and obtained, a non-refundable personal credit is available (CAD1,700 in 2009 for Ontario residents, for example). Unused credits can be transferred to a parent or spouse and can be carried back over ten years if there was eligibility during those years.

Once an individual is deemed eligible for the DTC, there are a range of other benefits that may be available to the person or their family, including the RDSP, extended Registered Education Savings Plan (RESP) contribution period and duration of the RESP, some tax-free disability-related employment benefits and child care expenses. The Canada Revenue Agency (CRA) provides helpful information on its website regarding the DTC as well as other credits and deductions that are available to the disabled person and his or her family and caregivers.

RRSP/RRIF rollovers

The general rule regarding Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) on death is that the full amount of the RRSP/RRIF is brought into the income of the deceased and taxed as such in the deceased's terminal tax return.[1] There is a rollover available to defer the tax if the surviving spouse is named as the beneficiary or successor annuitant and the spouse transfers the RRSP/RRIF to his or her own RRSP or continues as successor annuitant of a RRIF. Where a parent or grandparent names a disabled dependent child or grandchild as the beneficiary of the RRSP or RRIF, a rollover is also available.

To qualify, the child or grandchild must be considered financially dependent because of a 'mental or physical infirmity'. Whether a child or grandchild was 'financially-dependent' on the deceased annuitant is a question of fact. Prior to 2003, if the child's income in the year preceding the annuitant's death exceeded the basic personal amount for that year, the child was presumed to be not financially-dependent. An amendment to the Act raised the income threshold used for determining financial dependency of disabled children and grandchildren to CAD13,814 for deaths occurring after 2002 (subject to indexation).[2] Where the disabled child's income exceeds this threshold, financial dependence may still be established, depending on the factual evidence, including:

- the income of the child;
- the cost of living;
- the ability of the child to support himself or herself; and
- support provided by others.

RRSP/RRIF rollovers and provincial support to disabled persons

Provincial support

While the criteria for eligibility may vary, all of the provinces provide some form of disability benefits and support to qualifying individuals. Provincial plans typically provide that to qualify for benefits, the assets of a disabled person cannot exceed a specified amount. In Ontario, for example, the Ontario Disability Support Program (ODSP) permits a recipient to hold assets with a maximum value of CAD5,000 (exclusive of a principal residence, a car and a number of other assets) and to receive funds from other sources of up to CAD6,000 over a 12-month period.[3] Where a disabled person receiving provincial benefits receives an inheritance or gift, his or her provincial benefits may be jeopardised, depending on the amount of the inheritance, the income it provides and the manner in which it is left (directly or to a trust). Trusts commonly known as 'Henson trusts' are structured to ensure that a disabled person who inherits or otherwise receives funds from family members or others can retain his or her eligibility for government benefits.[4] In most provinces, the assets held in a Henson trust are not included in the person's asset base for purposes of determining eligibility; however, with the exception of distributions to pay disability-related expenses, the amount received by the beneficiary from the trust may not exceed the income threshold amount.

RRSP/RRIF rollovers and Henson trusts

If an RRSP or RRIF is transferred to a dependent disabled beneficiary, the tax deferral described above will be available, but the beneficiary will likely be off-side for provincial disability benefits. Proposed changes to the Act (new section 60.011)[5] were brought forward to alleviate this concern in many situations by providing for a rollover of the RRSP or RRIF to a 'lifetime benefit trust' where the beneficiary of the trust is either:

1. the spouse or common-law partner of the deceased individual and mentally infirm, or
2. a child or grandchild of the deceased individual and dependent on the deceased individual for support because of mental infirmity.

The lifetime benefit trust would be named as the annuitant of a 'qualifying trust annuity' purchased with funds from the RRSP or RRIF. A lifetime benefit trust is a personal trust under which:

1. no person other than the beneficiary (i.e., the disabled child or grandchild of the deceased annuitant) may, during the lifetime of the beneficiary, receive or otherwise obtain the use of the income or capital of the lifetime benefit trust;
2. the trustees have the authority to distribute amounts to the beneficiary; and
3. the trustees are required to consider the needs of the beneficiary in exercising their discretion to make distributions out of the trust or refuse to do so.

Note that the amendments appear to apply only to mentally disabled individuals. Recipients of provincial disability benefits who are physically disabled, but mentally capable may not be able to access these provisions.

In addition, concerns have been raised with respect to whether a standard Henson trust would, in fact, qualify as a lifetime benefit trust. One concern relates to whether there are other beneficiaries of the trust income at the end of the expiry of the accumulation period. In Ontario, for example, the *Accumulations Act* (R.S.O., 1990, c.A.5) requires the distribution of trust income after 21 years. The practice is generally to allow others (e.g., children or siblings of the disabled person) to receive excess income from the Henson trust following the 21st anniversary. This ensures that the income that the disabled beneficiary receives does not exceed the ODSP threshold. However, to qualify as a lifetime benefit trust, only the disabled person can benefit from the trust. The benefits of the Henson trust must be weighed carefully against the government benefits to determine the best and most tax effective vehicle to provide financial protection for a disabled beneficiary.

The new Registered Disability Savings Plan

The RDSP was first introduced with the 2007 Federal Budget and the ensuing legislation came into force on 1 December 2008. The RDSP is loosely modelled after the RESP structure, but with a lifetime maximum of CAD200,000 per beneficiary to be invested tax-free until withdrawal (RESPs have a CAD50,000 maximum). Like the RESP, the RDSP programme includes a government grant, the Canada Disability Savings Grant (Disability Grant), and also a Canada Disability Savings Bond (Disability Bond) for low and modest income families. The RDSP programme has been implemented through amendments to the Act and through the enactment of a new statute, the *Canada Disability Savings Act* (2007, c. 35, s. 136).

Eligibility for the federal RDSP programme is based upon eligibility for the DTC, age (under 60) and status as a resident of Canada. The disabled 'eligible person' is the plan beneficiary; anyone, including the plan beneficiary, the beneficiary's family members and persons not related to the beneficiary, may contribute to an eligible individual's RDSP.

As with RESPs, and unlike with RRSPs, contributions to an RDSP are not deductible from the contributor's income.[6] However, any income earned on contributions will accrue tax-free until paid out of the RDSP to the plan beneficiary. Disability Grants and Disability Bonds will also be taxable in the beneficiary's hands upon distribution.

Contributions to an RDSP are limited to a lifetime maximum of CAD200,000 in respect of a particular beneficiary, with no annual limit on contributions. Contributions are permitted until the end of the calendar year in which the plan beneficiary turns 59, and payments out of the RDSP are mandatory beginning in the following year. Only the plan beneficiary or the beneficiary's legal representative is entitled to receive payments from the RDSP; refunds to other contributors are not permitted.

In order to ensure the RDSP is a long-term planning vehicle, limits have been placed on the ability to withdraw funds from a newly-established RDSP. Essentially, a withdrawal prior to the calendar year in which the plan beneficiary turns 60 (termed a 'disability assistance payment') from an RDSP will be disallowed if the payment would cause the fair market value of the RDSP's assets to fall below the 'assistance holdback amount', which is defined as:

> 'at a particular time, the total amount of bonds and grants paid into an RDSP within the ten-year period before the particular time, less any amount of bond or grant paid in that ten-year period that has been repaid to the Minister.' (*Canada Disability Savings Regulations*, s.1)

Consequently, where payments are made prior to the year in which the beneficiary turns 60, certain government contributions to the RDSP may be clawed back.

The RDSP legislation provides that a parent or legal guardian can open and be the 'account holder' of an RDSP for a minor disabled person. As well, a 'public department, agency, or institution that is legally authorised to act for the beneficiary' of the RDSP can open a Plan for the minor disabled person. If the disabled person is an adult, he or she can be the account holder, provided he or she is competent. If the disabled person is not competent to enter into a contract with the financial institution, a 'qualified person' would open the account and be the account holder. Under the legislation, a qualified person is 'a guardian...or an individual who is legally authorised to act for the beneficiary; or a public department, agency, or institution that is legally authorised to act for the beneficiary.' The legislation appears to permit a parent who was the account holder while the beneficiary was a minor to continue as the account holder once the beneficiary reaches the age of majority; otherwise, it may be necessary for a parent or, more likely, other relative such as a sibling, to become the legal guardian of the adult disabled person in order to open an RDSP and be the account holder. This requirement may prove costly and cumbersome for families who, until now, have been able to deal with the disabled person's assets without a guardianship order.[7]

Canada Disability Savings Grant

RDSP contributions made in a given year will qualify for direct government assistance in the form of Disability Grants at matching rates of 100, 200 or 300 per cent, depending on net family income and the amount contributed. Once the RDSP beneficiary turns 18, the relevant 'net family income' for such purposes will be that of the beneficiary and his or her spouse or common-law partner. There is a lifetime Disability Grant limit of CAD70,000 for plan beneficiaries.

Canada Disability Savings Bond

Annual Disability Bonds are not contingent on contributions to an RDSP, and will be paid into the RDSPs of beneficiaries of lower-income families. The maximum annual Disability Bond of CAD1,000 will be paid where net family income does not exceed CAD20,883. The Disability Bond is gradually reduced to nil where net family income exceeds CAD37,177. There will be a lifetime limit of CAD20,000 on Disability Bonds paid in respect of an RDSP beneficiary. Again, once the beneficiary is 18, it is only his or her income that is considered. Where a disabled individual is receiving provincial disability benefits, it is likely that the person will qualify for the maximum Disability Grant and Disability Bond.

Contributions to an RDSP for 2008 could be made through 2 March 2009, so that the grants and bonds for 2008 remained available. The 2009 contribution year began 2 March 2009.

RDSPs and eligibility for provincial benefits

Until recently, it was unclear whether RDSP contributions and distributions would affect eligibility for disability benefits. In recent months most of the provinces and territories, including Ontario, have amended the regulations relating to disability benefits such that RDSP amounts will be ignored when determining eligibility for benefits.

Whether or not Henson trusts are used, all families planning for disabled individuals should consider making use of the RDSP programme in order to take advantage of the significant government contributions available.[8] The structure of the Disability Grant programme is such that even wealthy families may be eligible to receive upwards of CAD50,000 from the federal government (where contributions of at least CAD1,000 are made to an RDSP every year and are made beginning in the year of the disabled individual's birth). Where funds are limited and the family of the disabled individual has a lower net family income, subject to the above assumptions, in most cases priority should be given to contributing to an RDSP, in light of the potential for the direct government assistance (up to a maximum of CAD90,000 for low-income families) – keeping in mind the potential hurdle of obtaining a legal guardianship order, which would otherwise not necessarily be required.

In conjunction with Henson trusts and other planning tools for disabled individuals, tax and estate planners should encourage participation in the new RDSP programme, as it should provide much needed financial support for special needs individuals and their families.

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1 See Section 146 and para. 60(l) of the Act, and IT-500R 'Registered Retirement Savings Plans – Death of an Annuitant.'

2. Subsection 146(1.1)

3. The allowable income amount was increased from CAD5,000 to CAD6,000 as of November 30, 2008.

4. Named for the 1987 case of *Ontario* v *Henson (1987)* 28 E.T.R. 121, aff'd (1989) 36 E.T.R. 192, which confirmed that assets held in a discretionary trust for a disabled beneficiary are not included as assets for the purposes of determining eligibility for disability benefits in Ontario. Most other provinces have adopted this exemption.

5. As of the date of writing, the proposed amendments have not yet passed. When they do, they should be effective for Qualifying Trust Annuities acquired after 2005.

6. The 2006 'Expert Panel Report on Financial Security for Children with Severe Disabilities' recommended non-deductibility of contributions (the RESP model over the RRSP model) because the panel gave significant weight to the objective of targeting more of the benefits of the RDSP to those with lower incomes. As stated at page 19 of the Report, 'Such a deduction creates more benefit for those with higher incomes, those who, arguably, need a lesser incentive to save than do those with lower incomes.'

7. In Ontario, a simplified process may be available through the Office of the Public Guardian and Trustee.

8. British Columbia and the Vancouver Foundation will provide people with disabilities CAD150 towards their RDSP