Estate Planning for Beneficiaries with Disabilities

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Preparing your estate plan to accommodate the needs of a beneficiary with a disability, requires a thoughtful approach to ensure they will be properly accommodated and supported upon your death. Above all, it is important to consider the individual situation of the beneficiary(ies).

While evaluating the type of estate planning needed, it's important to start by examining the following:

1) **Personal circumstances:** This includes age, legal capacity and level of autonomy. Evaluate whether your beneficiary is expected to be financially self-sufficient or if they will rely on income-tested government programs.
2) **The nature of the disability:** Whether the beneficiary's level of autonomy will change over time, or if the financial needs of the beneficiary will increase in the future.

Age and legal capacity

There is no single age at which a person's legal status changes from "incompetent" to "competent" for all purposes, and age-defined thresholds in law also vary from province to province. Parents generally have the right to make personal care decisions regarding their minor children as part of their legal parental authority. However, there are limitations on such parental authority, including the child's own right to make decisions regarding their own health care.

An adult is presumed to have capacity to make their own decisions regarding property and personal care. When capacity is not an issue, persons with disabilities should be encouraged to prepare Powers of Attorney (called a "Mandate" in Quebec) allowing them to appoint another person to manage property or personal care if they become incapable. The documentation required is determined by the province in which the individual resides.

This presumption of capacity for adult persons can only be displaced by a finding of incapacity. If an adult is found to lack capacity, a legal guardian must be appointed by the court following a procedure that varies from province to province.

Providing for eligible beneficiaries

Individuals capable of managing their own affairs are likely to be financially self-sufficient, and may best be provided for by an outright gift. This may be achieved either through your Will, by beneficiary designation or by "joint ownership with right of survivorship", although the latter is not available in Quebec. Further details on jointly held assets are included in this article.

For a family member who remains legally autonomous but is impacted by a severe physical disability, who qualifies for the Federal Disability Tax Credit ("DTC") and is unlikely to be financially independent, a Registered Disability Savings Plan ("RDSP") may be appropriate. However, an RDSP may be less appropriate for an individual whose disability compromises their ability to manage their own finances. Such individuals may require the additional assistance and protection offered by a trust. Alternatively, a strategic combination of the two could be effective, using the RDSP to a more modest extent. More information on RDSPs and trusts is included in this article.

In all cases, it is important to ensure that basic government support for the beneficiary with a disability will continue where appropriate. In most provinces, legislation determines what level of income and assets the beneficiary of a disability pension can have, without affecting their benefits. Any income or assets received by the person over and above the prescribed limits will affect their pension or benefits. For example, in Ontario a beneficiary may receive up to $100,000 in a trust, provided that the capital of the trust arises out of insurance proceeds or from an inheritance.

Jointly held assets

Like an outright gift in your Will, a transfer of assets into joint ownership with a person with a disability may be appropriate where the individual remains legally capable and functions at a high level. Where the property is held as "joint tenants with right of survivorship," upon your death the jointly held property may pass directly to your surviving beneficiary and will not form part of your estate.

As with any transfer into joint ownership, such transfer may have tax consequences to you as the transferor. Care must also be taken to properly plan and document your intention to give the property to the person with a disability at the time of your death.

This strategy is not without risk to you while you are alive, as the property may be exposed to family law claims or creditor claims made against your beneficiary or joint owner. For those beneficiaries who are in receipt of provincial disability benefits such as the Ontario Disability Support Program, joint ownership may in some circumstances reduce their benefits.

Please note that the "right of survivorship" does not operate in Quebec and any interest in jointly held property in that province will form part of the estate to be dealt with according to the terms of the Will at the time of death.

Registered Disability Savings Plan

An RDSP is a tax-incented plan to encourage parents, family members and others to save for the long-term financial security of a beneficiary who qualifies for the Federal Disability Tax Credit ("DTC"). The holder of the RDSP can be the beneficiary if they are a legally competent adult. If the adult beneficiary is not mentally competent, their legal representative (legal guardian, Attorney for Property or an authorised institution) or a "qualifying family member" can become the holder of that person's RDSP. A "qualifying family member" can be the person's parent, spouse or common-law partner so long as they are living with the person with the disability. In the case of a minor beneficiary, a "qualifying person" can be a parent, guardian or authorised institution. Incentives include tax-deferred growth within the RDSP and eligibility to receive Canada Disability Savings Grants and Bonds within certain income-tested limits.

Contributions to the RDSP must be made within a lifetime contribution limit of $200,000 and may be made by anyone with the consent of the holder, up until the end of the calendar year in which the beneficiary attains the age of 59. These contributions can also be made as tax-deferred roll-overs from a RRSP, RRIF, or Registered Pension Plan held by the beneficiary's deceased parent or grandparent at the time of death, where the beneficiary with the disability is a financially dependent child (or grandchild). Such roll-over contributions are subject to the lifetime contribution limit and are not eligible for grant payments. The roll-over contributions can be made by a beneficiary designation in the RRSP, RRIF or pension plan document, or by a clause in the deceased's Will. In Quebec, the roll-over contributions can only be made by Will.

Please note that RDSP income must begin to be paid out to the beneficiary in the year in which the beneficiary turns 60. Withdrawals from the RDSP are not considered income to the beneficiary for the purposes of eligibility to the income-tested Old Age Security or, with some provincial variation, for provincial disability pensions. Withdrawals are subject to certain restrictions and may only be paid to the beneficiary or their estate.

Other planning techniques with registered plans

Your Registered Pension Plan, RRSP or RRIF can also be "rolled-over" on your death to defer the income tax otherwise payable to purchase a qualifying trust annuity for your mentally infirm spouse (married or common-law) or financially dependent child or grandchild. The child or grandchild's financial dependency on you must have existed at the time of your death and must have arisen from their mental infirmity. Such an annuity must be held in a Lifetime Benefit Trust ("LBT") for the eligible beneficiaries. This arrangement allows you to name the trustee(s) of the LBT in your Will. The trustee named by you will be the one to administer – on a discretionary basis – the annuity payments collected by the LBT, rather than the legal guardian, curator or attorney for that person. While the annuity payments are collected by the LBT, the qualifying beneficiaries will be deemed to have received those amounts for income tax purposes, whether they were paid to them by the trustee(s). This could potentially have a negative impact on the beneficiary' entitlement to other disability benefits, depending on the province. Any funds remaining in the LBT at the beneficiary's death will be distributed according to the terms of your Will.

Testamentary or inter vivos trusts including "Henson" trusts

Trusts are especially suited for persons with disabilities who may require additional assistance or protection in the management of their property. This is due to the high degree of customization and flexibility that can be achieved in a well-drafted trust. The terms of the trust can either be set out in a trust agreement which takes effect during your lifetime (an inter vivos trust) or in your Will and which; therefore, only takes effect on your death (a testamentary trust).

A trust that is entirely discretionary as to the payment of income and capital (also known as a "Henson trust") – whether inter vivos or testamentary – may be used to ensure that a person with disability benefits are maintained. There is no monetary limit applicable to a Henson trust, however, payments from the trust must comply with provincial disability legislation. The Henson trust concept is named after a 1989 Ontario Court of Appeal decision (Ontario Ministry of Community and Social Services v. Henson) and is commonly used to describe an absolute discretionary trust for the benefit of a person with a disability.

Due to the considerable decision-making power given to the trustee in these entirely discretionary situations, the trustee of a Henson trust should be chosen with great care. You may also consider preparing a "Letter of Wishes" to provide guidance to your trustee. Where the value of the trust fund is significant, it may be advisable to name a corporate trustee. It is important that the terms of the Henson trust be drafted concisely to ensure the continuation of disability benefits.

In some circumstances, a Henson-type trust may not qualify as a Lifetime Benefit trust for the purposes of qualifying for the tax-free "roll-over" of your RRSP or RRIF.

Please note that the use of a Henson-type trust may not be effective in all jurisdictions. For example, in Quebec there is only one decision of the Superior Court that recognises this type of trust. An experienced estate lawyer (or notary in Quebec) should always be consulted.

Qualified Disability Trust ("QDT")

Certain testamentary trusts (including a Henson trust) that meet the criteria for a QDT will benefit from preferential income tax treatment not afforded to other trusts. A QDT allows income of the trust to be taxed at graduated rates, rather than at the top marginal rate as with other types of testamentary and inter vivos trusts. In addition to providing income-splitting opportunities between the trust and beneficiary, a QDT gives the trustee more flexibility in determining the flow of income to the beneficiary. For the trust to qualify as a QDT, a beneficiary eligible for the Disability Tax Credit must jointly elect this tax treatment with the trustees on the tax return for the trust. Only one trust per beneficiary will qualify as the QDT for tax purposes. Where there are other beneficiaries of the same trust who do not qualify for the DTC and who receive capital distributions from the trust, the preferential tax treatment of the trust will be negatively impacted by a "recovery tax" claw-back of the tax savings afforded by the application of the graduated tax rates.

Preferred Beneficiary Elections ("PBE")

In circumstances where a trust is not eligible to be treated as a Qualified Disability Trust but nevertheless there is a beneficiary who is a person with a disability, the trust may be able to benefit from graduated rates on income otherwise payable to such beneficiary but retained in the trust. This is achieved in any year where a beneficiary and trustee make a joint "preferred beneficiary election" (i.e., the PBE), to tax in the hands of the beneficiary income or gains earned by the trust even though they are retained in the trust and not in fact paid to the beneficiary. In order to qualify as a preferred beneficiary election, the beneficiary must be resident in Canada at the end of the year and must either qualify for the Disability Tax Credit or be at least 18 years of age, a "dependant" (as defined in the Income Tax Act) of another person for support because of mental or physical infirmity, and not have income that exceeds the basic personal exemption amount. In addition, the preferred beneficiary must be the settlor of the trust, a spouse/common-law partner or former spouse/common-law partner, or child, grandchild, great-grandchild or a spouse/common-law partner of such persons.

Conclusion

The fundamental objective of an estate plan involving beneficiaries who are persons with disabilities is to provide financial security and support for the beneficiary in a manner appropriate to their needs and circumstances. Often it is not possible to anticipate exactly what those needs and circumstances will be at the time of your death. Accordingly, when devising your estate plan and drafting your Will, it is advisable to grant your executor and trustee as much discretion as possible to choose the best option or combination of options to meet the needs of your beneficiary in the most tax effective manner, while minimizing the income tax payable by your estate.

For more information, please speak with your BMO financial professional.

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