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Registered Assets & Disabled Beneficiaries

Parents and families of people with disabilities value peace of mind when considering and making plans for the financial support of disabled dependents for the rest of those dependents' lives. The Canadian government has improved support for the disabled and their families, guardians and caregivers, enacting various provisions in the Income Tax Act (Canada). Provincial governments have support programs as well, which have ongoing eligibility requirements covering the nature and extent of the disability and the financial situation of the disabled person and his/her family.

The Canada Revenue Agency (CRA) has a website that contains useful information on the various tax deductions and credits available to a disabled person, his/her family, guardians and caregivers. Provincial governments and territories have websites set up to provide information on their respective disability support programs.

The following information focuses on alternatives you should consider when looking at passing on registered assets to disabled, dependent spouses and children.

RRSP/RRIF Rollovers

Canada offers basically three individual owned savings plans that have preferred tax treatment in terms of deposits and accumulation. A Registered Retirement Savings Plan (RRSP) is the long-term savings program. A Registered Retirement Income Fund (RRIF) serves as the orderly income payout program. A registered annuity is a pensionized alternative to receiving income from registered savings. Variations exist to deal with funds that were originally part of a pension plan.

Normally, the full amount of a Registered Retirement Savings Plan (RRSP) and a Registered Retirement Income Fund (RRIF) are taken into income when an owner passes away. Income tax must be paid on this lump sum which is reported in the terminal tax return of the deceased. Income tax can be deferred if the funds are rolled over to a spouse's RRSP or RRIF when that spouse is either the named beneficiary of the plan or the successor annuitant. Essentially, the proceeds are transferred directly to the surviving spouse's plan, avoiding probate.

A rollover is also permitted when the owner of the plan names a child or grandchild as the beneficiary and that child is financially dependent due to a "mental or physical infirmity". The proceeds can be transferred on a tax-deferred basis to the RRSP, RRIF of a disabled, dependent child or an eligible annuity set up for a child or grandchild who is under the age of 18.

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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He annually provides 100's of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As a Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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Registered Assets & Disabled Beneficiaries

One challenge with rolling over registered funds to a disabled, dependent child and having those funds set up as an RRSP for that child is that the child will most likely be deemed to be offside or ineligible for provincial supports programs, for both financial and medical/dental coverage. Amendments to the Income Tax Act (Canada) were proposed to create a "Lifetime Benefit Trust" to deal with this scenario. Though, these changes have not been passed into legislation yet, governments treat the proposed amendments as being in force for situations arising after 2005.

Lifetime Benefit Trust

A lifetime benefit trust has been promoted as a way of dealing with registered savings and income plans when a disabled spouse or child has been named as the beneficiary on the death of the owner. Here is how it works.

When proposed legislative additions to the Income Tax Act (Canada), section 60.011are passed into legislation, the new section will permit you to set up a qualifying trust annuity which must be:

1) for the life of the taxpayer (with or without a guaranteed period) or
2) a fixed term equal to 90 years minus the age of the taxpayer who is the sole beneficiary of the life benefit trust.

The lifetime benefit trust may be established in a will to provide for the transfer of the RRSP/RRIF on the death of the testator. The trust is set up as the owner of a qualified trust annuity purchased with the transferred RRSP or RRIF proceeds.

The taxpayer or his/her legal representative must make an election to have paragraph 60.011(3)(b) of the Income Tax Act (Canada) apply to the amount claimed as a deduction under paragraph 60(l) in order to have the deduction apply to the purchase of the qualifying trust annuity by the lifetime benefit trust. The deduction is available to the surviving infirm spouse, child, or grandchild under paragraph 60(l) of the Income Tax Act (Canada).

The lifetime benefit trust is a personal trust where only the beneficiary of the trust is entitled to the income or capital of the trust during his/her lifetime.

The trust beneficiary is:

1) the surviving spouse, including common-law partner and is mentally infirm
2) a dependent child or grandchild of the deceased and is mentally infirm

The amendments to the Income Tax Act (Canada) appear to deal only with mental infirmities. This means that individuals with physical infirmities who are eligible for provincial supports programs like the Ontario Disability Support Program (ODSP) may not be able to take advantage of the lifetime benefit trust.

The trust terms empower the trustees to distribute proceeds to the beneficiary. The trustees have discretionary powers to make distributions, taking into consideration the needs of the beneficiary, including his or her comfort, care, and maintenance.

Any amounts paid out of the annuity will be fully taxable whether they represent income or capital. If there is a guaranteed period or a fixed term associated with the annuity and if death occurs during the guaranteed period or fixed term, then any amounts that would otherwise be payable after the death of the infirm beneficiary must be commuted into a single payment. The fair market value of the annuity at the time of the beneficiary's death is deemed to have been received by the beneficiary immediately before his or her death out of the annuity. Therefore, the remaining value of the qualified trust annuity will be fully taxable to the infirm beneficiary in the year of his or her death.

Provincial Disability Support Programs

As mentioned previously, provincial governments have support programs and benefits for the disabled. Each province has set up qualification criteria for eligible individuals. For example, provincial plans set out the amount of assets that a disabled person can own and the amount of income he or she can receive to qualify for provincial support. In Ontario, the ODSP limits an otherwise qualifying individual to have assets with a maximum value of $5,000 with certain exclusions like a principal residence, car, personal effects. Income is capped at $6,000 over any 12 month period. Careful estate and legacy planning is needed to preserve access to provincial support so that a gift or inheritance does not disqualify an individual from receiving provincial disability support. The size of the gift or inheritance,

whether it is left directly or via a trust and the amount of income generated by the assets can all impact eligibility for provincial disability support. A key point to keep in mind is that provincial support programs are linked. Disqualification on the basis of financial situation will also kick recipients off of medical/dental support.

Inheritance Trust

The Ontario Government sanctioned what we call the Inheritance Trust in 1993. The Inheritance Trust is created by the person with a disability and so is considered to be an Inter-Vivos Trust which attracts tax at the highest marginal tax rates. Modifications made in 1998 allow a person receiving Ontario Disability Support Plan benefits to inherit up to $100,000 without having benefits terminated. There are limitations. Money received from the Inheritance Trust will not affect the disabled beneficiary's entitlement to Ontario Disability Support Plan benefits if you follow the income rules. Specifically the rules exempt funds used for disability related items and the first $6,000 in a 12 month period paid to or on behalf of the beneficiary. When you don't follow the rules, then trust distributions will be deducted from the person's Ontario Disability Support Plan cheque on a dollar for dollar basis over the next 12 months.

The Ministry of Community and Social Services has stated that if the Inheritance Trust is at the maximum level of $100,000 and it earns interest which is not spent in the given year, then that interest amount will be deducted from Ontario Disability Support Plan cheques over the next year. This means that the Inheritance Trusts needs to be carefully managed so that they do not accumulate income once the trust assets reach the maximum level.

Henson Trust

You can set up an absolute discretionary trust to deal with disabled persons who receive gifts, inheritances and other financial support from their families, protecting them from disqualification from provincial disability support programs. A Henson Trust, named after the 1987 case, is one such trust. Assets held in a discretionary trust for the benefit of a disabled beneficiary are not included in any determination of eligibility for provincial disability benefits. Not all provinces recognize Henson Trusts. Also regulations can change and Henson Trusts are continually being challenged. The following provinces allow Henson Trusts: Ontario, British Columbia, Manitoba, New Brunswick, Nova Scotia, and Saskatchewan. The provinces that have challenged the Henson Trust include: Newfoundland & Labrador, Nunavut, and Northwest Territories. The status of Henson Trusts in Alberta is defunct.

Only distributions from the trust not used to pay for disability related expenses are included in income calculations. Trustees must take care not to exceed maximum income thresholds which will offset or disqualify disabled beneficiaries from provincial disability support programs.

The Henson trust can be established either as an inter vivos or a testamentary trust. Most Henson trusts are set up as testamentary trusts established in a parent's or caregiver's will.

A standard Henson style trust may not qualify as a lifetime benefit trust and so may not be able to receive registered assets on a rollover basis where the beneficiary is a disabled child. Normally, a Henson trust has safeguarding provisions to deal with excess income amounts so that the primary, disabled beneficiary remains within income thresholds established by provincial government disability programs. Specifically, provincial legislation like the Accumulations Act in Ontario, require distributions of all trust income after 21 years. This rule may drive a disabled beneficiary's income over the maximums set up in provincial disability support programs, so excess amounts are paid to other beneficiaries.

Remember that a lifetime benefit trust is a personal trust where only the beneficiary of the trust is entitled to the income or capital of the trust during his/her lifetime. You will need to assess the benefits and drawbacks of a standard Henson Trust when setting up strategies and structures for a disabled person.

Registered Disability Savings Plan (RDSP)

The Sustaining Canada's Economic Recovery Act, Bill C-47 including the legislation for the rollover of registered assets to Registered Disability Savings Plans became law in December, 2010. The Income Tax Act (Canada), s. 60.02, permits a rollover of a deceased individual's RRSP, RRIF or Registered Pension Plan (RPP) proceeds to the Registered Disability Savings Plan (RDSP) of a financially dependent infirm child or grandchild on a tax-deferred basis.

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A competent, disabled adult can be the account holder of a Registered Disability Savings Plan. A "qualified person" can be the account holder for a disabled adult person who is not mentally competent. The legislation defines a "qualified person" as a guardian, an individual, agency, public department or institution who is legally authorized to act for the beneficiary.

Most jurisdictions in Canada ignore payments from these plans when determining eligibility for provincial disability support programs.

Proceeds from an RRSP, RRIF or lump sum payments out of a Registered Pension Plan (excluding actuarial surplus) can qualify as specified Registered Disability Savings Plan payments.

A specified RDSP payment:

- is an amount paid after June 2011 to a Registered Disability Savings Plan under which an eligible individual is the beneficiary
- must be designated as a specified RDSP payment by the eligible individual
- will be included in the recipient's income on withdrawal from the Registered Disability Savings Plan
- complies with the following Registered Disability Savings Plan contribution conditions:
  - a) contributions may not be made to the plan in any year in which the beneficiary is not eligible for the disability amount tax credit or after the death of the beneficiary
  - b) contributions may only be made if the beneficiary is a resident of Canada
  - c) contributions may not be made after the end of the year in which the beneficiary turns age 59
  - d) contributions must not exceed the lifetime maximum of $200,000
  - e) the account holder must provide written consent for the contribution

Conclusion

Infirm spouses as well as infirm children and grandchildren who are dependent on their parent or grandparent due to their infirmity have a number of trust structures available that you can explore and set up to receive and administer any RRSP/RRIF proceeds bequeathed to them by their deceased spouse, parent, or grandparent. The choice of investment vehicle is much broader with a rollover to an RRSP or RRIF as in any RRSP/RRIF. There are more restrictions in dealing with the lifetime benefit trust and associated qualifying trust annuity since only specific kinds of an annuity can be purchased. That said, the lack of investment choice with the Lifetime Benefit Trust structure does provided certainty of fixed and secure annuity payments which will not be subject to the investment fluctuations that an RRSP or RRIF may face, especially if the RRSP or RRIF is self-administered.

There is another advantage of the Lifetime Benefit Trust over an RRSP/RRIF rollover. Any amount in the Lifetime Benefit Trust remaining after the death of the mentally infirm beneficiary is potentially available to other beneficiaries named in the trust to receive the remaining proceeds after the death of the infirm beneficiary. There would most likely be little ability to bequeath the remaining proceeds by will in an RRSP/RRIF held directly by a mentally infirm person, given the reduced or limited legal capacity of the infirm person. The same holds true for beneficiary designations named in the RRSP or RRIF directly since the estate is the prescribed option. This will result in a legal devolution based on an ab intestate succession of the infirm person. This allocation of the proceeds according to provincial intestacy laws may not be what the original RRSP/RRIF annuitant had wished or planned for, especially in the case of second marriages and families with children from different marriages.

The Registered Disability Savings Plan complements a Henson or absolute discretionary trust. The Henson Trust has to deal with the effects of inflation which reduces the purchasing power of the funds left behind by families and caregivers in the trust. A Registered Disability Savings Plan can help offset the decreased purchasing power over time of assets left in a Henson Trust. This is an example of an and-and strategy, as opposed to an either/or approach to addressing the financial needs of disabled dependents.

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The restrictions on the withdrawal timing and amounts on the RDSP limit its effectiveness when more that the legislated withdrawal amounts are needed by the person with the disability. The Henson Trust has no such restrictions and so larger, periodic amounts can be taken from it. It can also be noted that sometimes the RDSP funds will be available before the Henson Trust. Generally the Henson Trust funds will become available at the death of the parents while the RDSP funds may become available before the death of the parents and no later than the year in which the beneficiary turns age 60.

The effective, coordinated application of rollovers of registered assets to a disabled dependent spouse, child or grandchild using Registered Retirement Savings Plans, Registered Retirement Income Funds, Lifetime Benefit Trusts, absolute discretionary aka Henson Trusts and Registered Disability Savings Plans will serve to provide these loved ones with dignity and the quality of life we hope for them and that they deserve for the rest of their lives.

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