David Chen, B.Sc., B.A., CSA (Certified Senior Advisor)
(Associated with Sun Life Financial Services)
10470 – 152nd St., Suite 170, Surrey, BC, V3R-0Y3
ph: 604-889-7782, email: info@dccompletefinancial.com
M-Th 10am–10pm, Fri 10am-4pm, Vancouver, Surrey offices & mobile services serving the lower mainland

Disability tax and estate planning

Does your estate plan include assisting or protecting an individual with mental and/or physical disabilities? Many disabled individuals receive social benefits that are subject to income and/or asset tests. The following is an overview to tax and estate planning for those providing for disabled individuals. Careful planning will allow you to leave a financial gift in a manner that can most effectively add to your heir's security and quality of life.

Creating a secure future

The plans you make can have a major impact on the financial future of your disabled heir. Financial planning during your lifetime and a careful estate plan to deal with your assets when you die are two important areas that you and your advisor should discuss. Preparing a plan now can insure that later on your assets are distributed the way you want. For example, you may minimize income tax and any probate tax on your estate and where appropriate, ensure your disabled heir benefits from your gift while continuing to be eligible for social assistance.

Government and private pension benefits

Disabled individuals may receive a number of federal, provincial and/or private benefits, provided they satisfy the qualifications. Canada Pension Plan disability benefits, for example, are available to people who meet the plan's disability and contribution requirements. Private disability plans are purchased privately or through an employer. They also provide benefits to people who become too disabled to continue working. There are also provincial worker's compensation schemes that may provide benefits in the case of disabling or partially disabling workplace injuries. These plans are not income-tested, and generally would not be affected by an increase in assets from inheritance.

Public disability benefits are generally taxable, such as CPP and Employment Insurance disability benefits. However, benefits received under Workers Compensation are not taxable. Private or group disability benefits are generally not taxable if the premium was paid by the employee or considered a taxable benefit to the employee.

Provincial support programs

In addition to allowances and tax credits available from the federal government, every province has guidelines for claiming social benefits. Eligibility is usually based on the level of assets and income the individual owns or receives, as measured by a means test. For example, Ontario's Disability Support Program is a provincially sponsored program that qualifies recipients based on assets owned and income earned. Some provinces will include an interest in a trust as part of the asset calculations while other provinces do not.

Non-refundable government tax credits and deductions

Non-refundable tax credits can reduce the amount of income tax payable by a disabled individual. The

This document is for informational use only. No warranty regarding legal accuracy is expressed or implied and no liability for its use is expressed or implied.

value of these credits decreases when income (from pensions, investments, employment, etc.) reaches a specified level. Specific benefits are the Disability Tax Credit, the Medical Expense Deduction, the Caregiver's Credit and the Attendant Care Expense Deduction. In addition to income limits, qualifications relating to dependency and age (a minor, an adult, or someone over 65) will influence what can be claimed. In some cases, claiming one credit will result in the individual being unable to claim another credit. For example, if an individual claims attendant care fees in excess of $10,000 under the medical expense tax credit, then the disability tax credit cannot generally be claimed.

If there are more tax credits than tax liabilities, some of the excess credit may be used by the person supporting the disabled individual. As a result, income generated from inherited assets may impact the tax credits allowed to your heir and must be planned for carefully.

What happens if the primary caregiver dies?

Your will should record your wishes for all of your heirs, but it's especially important, if you are the primary caregiver, to anticipate and plan for a disabled individual's long term requirements, which include:

- Where and with whom he or she will live?
- What financial support will be required for living accommodations?
- Who will manage his or her property if he or she is mentally incapable of doing so?
- Who can or will act as substitute decision-maker if one is required?

Give careful consideration to whom you name as your personal representative (estate trustee / liquidator / executor), because this individual is critical to ensuring that your wishes are carried out.

Inheritance and government benefits

If an inheritance is paid directly to a disabled heir, then the asset and any income and/or capital gains subsequently generated by the inheritance is taxable in the heir's hands. This could lead to reduced or denied federal or provincial social benefits.

Some of assets that may disqualify a disabled individual from social benefits may not be obvious so seek the advice of a specialist in this field.

Why trusts can be an option

There are many benefits to including trusts in your estate plan, including:

- Control
- Reduced taxation
- Potential to retain government benefits

If you are faced with your own disability or have other planning needs, you may want to isolate certain assets within a trust during your lifetime (referred to as an *inter vivos trust*). You could continue to receive income from the trust during your lifetime and you can name the disabled individual as a contingent beneficiary, to receive the assets upon your death. The use of trust may reduce probate taxes payable upon your death as the assets may pass outside of your estate. Generally, property is deemed disposed of when it is transferred into a trust, resulting in immediate

David Chen, B.Sc., B.A., CSA (Certified Senior Advisor)
(Associated with Sun Life Financial Services)
10470 – 152nd St., Suite 170, Surrey, BC, V3R-0Y3
ph: 604-889-7782, email: info@dccompletefinancial.com
M-Th 10am–10pm, Fri 10am-4pm, Vancouver, Surrey offices & mobile services serving the lower mainland

tax implications to the settler (the person who is putting the asset into the trust). Exceptions exist for transfers to spousal trusts and to alter-ego or joint partner trusts.

Income taxed in an *inter vivos* or "living trust" is taxed at the highest marginal tax rate as long as the trust exists. In many cases the income and /or capital gains can be taxed in the hands of the beneficiary, at his or her marginal tax rate. However, in the case of a disabled beneficiary receiving income-tested benefits, this income may affect his or her benefit entitlement. Depending on the relationship between the donor and the beneficiary, income and/or capital gains may be attributed to the donor.

Trusts (other than trusts that benefit a surviving spouse or partner) are generally deemed to have disposed their capital property every 21 years. This rule results in a tax liability on any increase in the value of the assets in the trust. Some provinces do not allow the accumulation of income within a trust for more than 21 years, which means that in some cases income, must be paid out to the disabled beneficiary at that time.

If income-tested social benefits are on the line, then think carefully about whether a trust is right for your situation. Also, who will act as trustee or any trust you establish. Keep in mind that if you expect the trust to run for a lifetime, then having a contingent trustee or a corporate trust may be a good idea.

Income splitting using the preferred beneficiary election

A special election can be made to allow the trust to retain income but have income tax paid by a so-called "preferred beneficiary". This is someone who usually pays tax at a lower rate than the trust, or other beneficiaries of the trust. The preferred beneficiary (who can be a spouse, partner, child, grandchild or great-grandchild of the settler) must qualify for the disability tax credit, or be dependent on another person because of mental or physical infirmity. In addition, his or her income must not exceed the basic personal amount. A preferred beneficiary election must be signed by the trustee and the preferred beneficiary (or a legal representative) each year that the trust exists.

Once the preferred beneficiary pays the tax, the trustee can decide to leave the income inside the trust for future use, pay it to the preferred beneficiary, pay expenses on behalf of the beneficiary, or pay it to any other beneficiaries who may be named in the trust. It is important to keep in mind, however, that although this may result in lower taxes for the group of beneficiaries overall, it may affect the preferred beneficiary's entitlement to income-tested benefits.

Discretionary testamentary trusts (Henson Trusts)

Henson trusts are named after an Ontario case in which an estate worth approximately $82,000 was left to a daughter who had been receiving provincial income support. The instructions under the Will gave power over the trust to the trustees. The daughter was entitled only to payments made to her by her trustees.

However, the provincial government felt that the money in the trust belonged to the daughter and decided she was no longer eligible for income support. The case went through court, and the final decision was that the assets in the trust did not affect her eligibility for social benefits.

This document is for informational use only. No warranty regarding legal accuracy is expressed or implied and no liability for its use is expressed or implied.

A Henson trust is a testamentary trust is a trust that is set up under a will. Specific instructions may be included in the will regarding payments to beneficiaries under a testamentary trust. The deceased can choose to give the trustee(s) full control as to when, if and how much income is to be paid to the disabled beneficiary. Any income taxed within a testamentary trust is taxed at the graduated marginal tax rates. If the beneficiary is eligible for income-tested benefits, then the trustee can restrict the payment out of the trust to an amount that will allow the beneficiary to retain his or her benefits. This type of discretionary testamentary trust for a disabled beneficiary is often referred to as a Henson Trust.

It is important to determine whether or not the applicable provincial legislation excludes an interest in a discretionary trust when determining an individual's benefits eligibility. For example, Alberta has introduced legislation to include an interest in a discretionary trust as part of the assets of a beneficiary.

A testamentary trust may also be useful if there is a need to protect someone who cannot manage money on his or her own, or who is, or may be, at risk of financial abuse by others. The deceased can designate a contingent beneficiary to receive the trust property at the death of the disabled beneficiary. This is particularly advantageous if the beneficiary is incapable of preparing his or her own will, in which case the intestacy rules (no will rules) would generally apply upon the beneficiary's death to assets left to the individual directly.

Beneficiary designations on registered plans

If you have an RRSP or RRIF, there are additional options for you in minimizing the income tax payable by your estate. Tax-deferred rollovers, called refund of premiums (for RRSPs) or designated benefits (for RRIFs), may be available if your beneficiary is your spouse or common-law partner or financially dependent child or grandchild.

The value of the RRSP or RRIF upon your death will be taxable to the beneficiary spouse, who can generally offset the income by transferring the amount into their own RRSP or RRIF.

The value of an RRSP or RRIF that is included in your income at death can be reduced if it is being treated as a refund of premiums or designated benefit to a beneficiary who is financially dependent child or grandchild. A disabled (grand)child will generally be considered financially dependent if their income in that year does not exceed basic exemption amounts ($9,600) plus $6,890 for a maximum income of $16,490 (based on 2007 values for death occurring in 2008, indexed annually). If your beneficiary is financially dependent and disabled, then they may transfer the refund of premiums into their own RRSP or RRIF to maintain the tax-deferred status of the funds.

Proposed amendments to the Income Tax Act (Canada) will to allow a refund of premiums or a designated benefit to be used to acquire a life annuity. The annuitant must be a trust and the disabled person must be the only person beneficially interested in amounts payable under the annuity. In order to qualify, the beneficiary must be (grand)child who is financially dependent on you because of physical or mental infirmity. Another alternative is to have the RRSP or RRIF proceeds settled into a testamentary trust at the time of your death. Probate taxes may be payable in some provinces on the proceeds of the RRSP or RRIF that flow through the estate.

Insurance

Many people do not have enough estate assets to maintain the support of a disabled beneficiary throughout his or her life, free of any public assistance. Consequently, many people use life insurance to ensure that sufficient assets will be available to meet the disabled beneficiary's needs. These proceeds, depending on the amount and the needs of the disabled individual (including the protection of means-tested government benefits), could be placed within a trust or paid directly to your heir. In the case of a disabled heir, sometimes it may be better for insurance proceeds to be paid into your estate to protect social benefits or to protect the money for future use. Under these circumstances,

David Chen, B.Sc., B.A., CSA (Certified Senior Advisor)
(Associated with Sun Life Financial Services)
10470 – 152nd St., Suite 170, Surrey, BC, V3R-0Y3
ph: 604-889-7782, email: info@dccompletefinancial.com
M-Th 10am–10pm, Fri 10am-4pm, Vancouver, Surrey offices & mobile services serving the lower mainland

the proceeds are subject to applicable probate taxes and/or possible creditor claims. Alternatively, consider setting up a separate insurance trust. Insurance proceeds can be rolled into a Henson trust to help your disabled heir maintain his or her benefits.

Estate planning – personal considerations

What happens if the primary caregiver becomes disabled too? If you are caring for someone who is disabled, the greatest challenges can arise when your own circumstances make it difficult for you to continue in a caregiver role. There are a number of issues to consider, including the physical and mental capabilities of the disabled individual, the structure of a life plan for him or her and estate planning for both of you. If your heir is not mentally competent and cannot write his or her own Will, then any estate assets owned by the individual at the time of his or her death will be distributed under provincial rules of intestacy, which could impact your overall plans.

If you are the primary caregiver of a disabled individual and have a disabling condition yourself, you need to have powers of attorney (known as a representation agreement in British Columbia or mandate in Quebec, and preferably an "enduring" representation agreement). This ensures that an appropriate person can and will manage any necessary decisions relating to your property and health care. The person you appoint (called a substitute decision maker) should understand the responsibility of not only caring for you but also of continuing the care you have been giving to the disabled individual.

It's important that your substitute decision maker has the legal authority to meet your needs, as well as those of any disabled individual whom you wish to assist. In addition, you will want to ensure that your substitute decision maker will have the required legal authority to use your assets to benefit someone other than you. Finally, it's important to name someone who can act in your place to ensure continuity for the disabled individual.

Choosing the best options

Planning to take care of yourself and extending your plan to those you care about can be complicated. Every family and individual is unique, so it is important that you talk with your advisor, lawyer and/or tax advisor to find out the options that are best in your situation and for the goals that you are trying to attain. Provincial regulations and laws vary, so it's important that you understand the rules where you live. Once you have your plan in place, don't forget to review it from time to time or as your circumstances change.

This document is for informational use only. No warranty regarding legal accuracy is expressed or implied and no liability for its use is expressed or implied.