

Seminar Handout

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Presented By: Ted Pease, Lawyer
Certified Specialist in Estates and Trusts Law
www.mcintosh-pease.com
ted@mcintosh-pease.com

Presented To: Community Living Brant

Topic: Henson Trusts vs. Registered Disability Savings Plans

A. Henson Trusts:

What are they?

- a great estate planning tool for parents of an adult disabled child on ODSP or minor children where the parents think that the child may later qualify for ODSP.
- the rules relating to ODSP benefits are set out in the Ontario Disability Support Act and the regulations to the Act.
- the problem is that ODSP benefits are only available to recipients with less than \$5,000 in assets, so the benefits will be jeopardized if the child inherits more than that amount from an estate or as a beneficiary of a life insurance policy.
- the goal is to set aside the child's share of the estate in a fully discretionary Henson Trust so that ODSP benefits, including the monthly income and drug and health benefits are not lost and so the Trustees can disburse cash, services and goods in compliance with the regulations to improve the quality of life of the child.
- can be set up during life (inter vivos trust) or in your Will (testamentary trust). The vast majority are set up in Wills as it is cheaper and ownership of assets typically stays with the parents until both pass away.
- there is no limit on the amount that can be held in the trust, however an ODSP recipient can only receive up to \$5,000 per year from the trust or any other source. I understand that they are considering increasing it to \$6,000.

Who to choose a Trustee?

- administering a Henson Trust demands a sophisticated Trustee who will create a payment scheme that will not jeopardize the public benefits. Clients often wish to appoint their other children as they want to help their sibling and understand their needs; however they are in a conflict of interest as they are likely the ultimate capital beneficiaries on the disabled sibling's passing if they leave no issue. If

the clients insist on appointing one of their other children I recommend a team of 2 or 3, being the sibling plus one or two unbiased outsiders that understand how the trust is to be run so as not to go offside. I have been asked to act as a Trustee by many clients as I understand the rules. It is also important to name alternate Trustees, especially if the child is a minor or young adult, to ensure there are always Trustees able to act.

When are they inappropriate?

- if the child has significant assets already a Henson Trust is of little use as the child would not qualify for ODSP. However, a trust should be set up in the parents' wills if the child's assets are expected to dissipate during the child's life. Note the child cannot simply give the assets away in order to qualify for ODSP as the Director can refuse benefits if an applicant has transferred assets for inadequate consideration within 3 years of the application.
- very wealthy parents may well prefer not to utilize a Henson Trust as they can afford to leave sufficient assets outright or in a non-discretionary trust to provide a good lifestyle for their disabled child without them resorting to ODSP. However, my experience is that most parents would rather utilize a Henson Trust so as to maximize governmental benefits thus retaining as much of their estate for their families.

Why be concerned that wills are revocable?

- I ensure that my clients are aware that wills are revocable and not a contract.
- my concern is that most couples want to do what I call "Estate Planning 101". They want wills leaving everything to each other then on the second to die leave everything to their children equally, either outright or in a Henson trust for a disabled child's share. In addition, they hold all assets jointly and designate each other as beneficiaries of their RRSPs and life insurance so the surviving spouse receives the assets immediately on death by right of survivorship, outside of the will. I make sure that they understand that all control is lost. The surviving spouse could change their will and leave out one of the children, or could remarry, which voids the existing will, and the new spouse could inherit substantial assets. Also, the surviving spouse could spend the money or be taken advantage of.
- this is a concern in 100% of second marriage situations where each spouse has children from a prior marriage.
- it is also a concern in first marriage situations where:
 - i. one spouse has inherited a family business, farm, cottage or substantial assets which they want to make sure go to their children and not their spouse's future spouse.

- ii. they have a disabled child and they want to make 100% sure that his/her share of the couple's estate goes into a Henson Trust for that child.

What are the recommended solutions to this problem?

- i. Spousal Trusts:

I recommend that all couples with a disabled child set up spousal trusts in their wills for some or all of their assets, instead of leaving all assets to each other outright. Spousal trusts typically provide that the surviving spouse receives all income from the trust annually plus discretionary payments from capital if needed and approved by the Trustees.

On the death of the surviving spouse the alternate residuary beneficiaries, usually the children, would receive the capital remaining in the trust 100% of the time, outright or in a Henson Trust for a disabled child or in trust for minor children as appropriate. The control and protection achieved is the main benefit of utilizing spousal trusts since by utilizing spousal trusts they would be taking care of each other for life and guaranteeing that their children inherit their assets not a future spouse or boyfriend/girlfriend of the surviving spouse.

Spouses can control outside the wills which assets flow into their estate and the spousal trusts. Only assets held in each spouse's name alone on death or RRSPs or life insurance proceeds where the "estate" and not the spouse is the beneficiary flow into the trust for his/her spouse.

There are also income tax savings enjoyed by the surviving spouse as a testamentary spousal trust enjoys graduated tax rates.

However, one downside is that probate fees may be payable on the first to die on assets that flow into a spousal trust rather than the second to die, but the chief downside is that the surviving spouse lacks control over the assets held by the trusts.

Choice of Trustees is very important and a professional trustee such as a lawyer or accountant is often appointed as they understand how the trusts are to be administered. If both spouses are involved in the family finances, a professional is often appointed as a co-Trustee along with the surviving spouse. I have been asked by many of my clients to be the Trustee of their spousal trusts.

Married couples who have not entered into a marriage contract or other form of domestic contract as defined in the Family Law Act of Ontario (herein, the "Act") must bear in mind that the surviving spouse will have six months from the date of death of their spouse to decide whether to take under the terms of the Will and insurance policies and RRSPs of their spouse or to require an equalization payment pursuant to clause 5 (2) of the Act which provides as follows:

“Death of spouse:

(2) When a spouse dies, if the net family property of the deceased spouse exceeds the net family property of the surviving spouse, the surviving spouse is entitled to one-half the difference between them. R.S.O. 1990, c. F.3, s. 5 (2).”

I recommend that spouses who wish to set up spousal trusts in their wills retain a family law lawyer to calculate the applicable equalization payment as I do not practice family law. Only

if that is done can an educated guess be made whether the surviving spouse will likely “break” the spousal trust by requiring an equalization payment. If he or she does decide to take the payment he/she is deemed to predecease the other spouse and forfeit all benefits under the will so the spousal trust is never set up, the balance of the estate goes directly to the children or trusts for the children.

ii. **Mutual Wills:**

If notwithstanding my recommendation clients choose not to utilize spousal trusts I recommend that they consider instructing me to prepare Mutual Wills with a separate agreement not to change their wills or artificially deplete their assets without the consent of the other or after one spouse passes away. This type of arrangement offers far more protection than simply signing reciprocal spousal wills, but offers nowhere near the protection provided by spousal trusts.

The following are the downsides of doing Mutual Wills with a side agreement. First, the agreement can be broken by the surviving spouse gifting away assets during life, utilizing jointly held assets with others or otherwise depleting the couple’s combined assets by spending, being taken advantage of or by making poor investment decisions. Also, legal costs increase when Mutual Wills are used. However, the main concern is that if the agreement is broken by the surviving spouse our children have no remedy but to sue the estate of the parent who broke the agreement for breach of contract. Unfortunately litigation can take years to resolve and cost many tens of thousands of dollars.

I recommend that clients who wish to sign Mutual Wills each first seek independent legal advice otherwise a court may not enforce the doctrine of mutual wills. This is because they need to be properly advised given that they would be giving up a basic right, that of testamentary freedom to change their wills in the future.

Most of my clients with a disabled child have included spousal trusts in their Wills with all or most of their assets.

B. Registered Disability Savings Plans (RDSP):

What are they?

- they are defined under the Canada Disability Savings Act, which was passed on December 14, 2007 and provided that the earliest a RDSP could be sold/created is December 1, 2008.
- the plans encourage long term saving for persons with severe disabilities as they are enhanced by government contributions, with a lifetime limit of \$200,000, no annual contribution limit and one plan per beneficiary and one beneficiary per plan. Anyone can contribute to a plan, with the holder’s consent.
- typically set up at a bank (Trustee) by the parents (holders) of a minor child, but can be set up by an adult beneficiary or the legal representative of an adult beneficiary or an institution legally responsible for the beneficiary.
- conditions for establishing an RDSP are the beneficiary must be a resident of Canada and entitled to the disability tax credit. Government contributions are made only in years that the beneficiary is entitled to the disability tax credit. This

could be a concern if it is possible or likely that the child may not qualify every year for the credit. I understand that disabled persons may qualify for ODSP but not qualify for the federal disability tax credit.

- main purpose is to provide a lifetime disability assistance payment (LDAP) to the beneficiary, which is based on a formula in the Income Tax Act. The payments must begin no later than the beneficiary's 60th year after which no further contributions can be made. Payments may in certain cases, such as where there is a shortened life expectancy, be made before age 60. Payments are partially taxable in the beneficiary's hands, somewhat like with an RRSP.
- Early payments/withdrawals (before age 60) can trigger paybacks of much of the grants and bonds so must be considered carefully.
- RDSP income does not affect entitlement to the GST credit, the Canada Child Tax Benefit or OAS payments

What happens when the beneficiary dies or becomes ineligible?

- when the beneficiary dies or becomes ineligible for the Disability Tax Credit, in addition to repaying an assistance holdback amount as defined, the plan must be collapsed and the plan proceeds paid to (and the taxable portion taxed to) the beneficiary's estate or the beneficiary as applicable.
- This can lead to problems as discussed below!

How does the government help build the plan?

- government assistance to an RDSP will be in the form of the Canada Disability Savings Grant to a lifetime maximum of \$70,000 and lower income families may qualify for payments from the Canada Disability Savings Bond program without having to make a contribution to an RDSP up to a lifetime maximum of \$20,000.

Grants:

i. Family Net Income up to \$75,769:

- on first \$500, \$3 for every \$1 contributed, to a maximum \$1,500
- on next \$1,000, \$2 for every \$1 contributed, to a maximum of \$2,000

Example: contribution of \$1,500 plus grants of \$3,500 = \$5,000/year

ii. Family Net Income greater than \$75,769:

- on first \$1,000, \$1 for every \$1, to a maximum of \$1,000

Example: contribution of \$1,000 plus grant of \$1,000 = \$2,000/year

Bonds: (no contributions required)

- i. Family Net Income below \$21,288: maximum annual bond = \$1,000
- ii. Family Net Income above \$21,288 up to \$37,885: smaller bonds

Note:

- income thresholds are for 2008 and adjusted annually
- family net income is for the parents or primary caregivers of the beneficiary. When a beneficiary turns age 18 the payments are based on the net income of the beneficiary and his/her spouse or partner, not their family's income
- the last day a beneficiary is entitled to a grant or bond is December 31st of the year he/she turns age 49.

Government assisted growth alone makes the RDSP an excellent way to save for the needs of a disabled child!

How do they compare with RRSPs/RRIFs and RESPs?

- unlike an RRSP but like and RESP there is no tax credit for funds contributed to the plan, but like in all registered plans the funds held within an RDSP grow on a tax-deferred basis.
- unlike all other registered plans, the RDSP holder is not the beneficial owner of the funds held in trust in the plan, the trustee holds the funds for the exclusive benefit of the designated beneficiary. Unlike an RESP, where the parent remains the beneficial owner of the fund and retains control over the fund, including control to withdraw capital and change the beneficiary, contributions to an RDSP are irrevocable gifts for the benefit of the beneficiary and cannot be retrieved by the holder.

What are some problems and concerns with RDSPs?

i. Lack of Capacity to Manage Affairs:

- the beneficiaries of the plans may have a greater likelihood of being legally incapable of managing their property. Where the beneficiary is between 17 and 59, he or she must be able to request payments from the Trustee. In other registered plans such as RRSPs, RRIFs and RESPs only the holder can compel payments from the financial institution.
- the problem arises from the fact that the parent will no longer be a "qualifying person" when the beneficiary turns 18. Accordingly, where a parent sets up a RDSP for a minor and the parent knows or suspects that the beneficiary will not be capable of managing property at the age of majority, the parent will have to apply to be appointed guardian of the child's property, which is complicated, time

consuming and can be expensive. Otherwise the plan may be terminated. By contrast, parents of children on ODSP do not usually have to take this step and are able to help with their child's finances for many years without becoming their guardian for property. Hopefully, the legislation will be amended to avoid this result.

ii. Lack of Testamentary Capacity:

- a further problem arises from the fact that a beneficiary may lack testamentary capacity and will die intestate thus requiring a family member to apply for a Certificate of Appointment of Estate Trustee without a Will and pay probate fees of 1.5% on the value of the plan before the bank will pay out the funds in the plan, which could total upwards of \$200,000, to the beneficiary's estate.
- I am concerned that if the beneficiary should marry during his/her life then on an intestacy his/her spouse would inherit the estate including the funds in the plan. This may result in some vulnerable beneficiaries being taken advantage of, i.e., a boyfriend or girlfriend finding out about the amount of funds in the plan and marrying the beneficiary in order to inherit the funds. My concern lies partly in the fact that the test for the legal capacity to marry is one of the lowest tests. The level of capacity to prepare a Power of Attorney for Personal Care is probably a bit higher and the highest level of capacity is required for signing a Will and Power of Attorney for Property.
- note that if the beneficiary has children they would also share the estate with the spouse under an intestacy.
- if the beneficiary does have capacity, he/she can make a Will setting out who is to inherit any funds remaining in the plan on his/her passing. The executor of the Will would then apply for probate, pay probate fees and obtain the funds from the bank and distribute them in accordance with the Will. This is certainly preferable to there being an intestacy as the beneficiary controls who is to inherit the funds in the plan not a statute. My concern where there is a Will is that marriage voids a Will so the risk set out in the preceding paragraph remains!
- my experience is that most people on ODSP lack the capacity to do a Will or sign a Power of Attorney for Property, so I would have thought that most beneficiaries of RDSPs will die intestate. However, I recently was advised by someone working with disabled adults on ODSP that most of them were encouraged to obtain Will kits and in fact signed Wills dealing with their meager assets even though they may well have lacked testamentary capacity. My concern about this practice is that there is now a much greater risk of future litigation as a RDSP could result in the beneficiary's estate being worth up to \$200,000, a very significant amount. Disinherited family members or others may well sue to set aside the Will for lack of testamentary capacity!
- the above problems exist because current provincial laws do not permit the holder to name a contingent beneficiary in the plan should the primary beneficiary die before receiving all of the proceeds by way of disability assistance

payments. It is uncertain whether some day there will be amendments to provincial law that will allow the holder to name a contingent beneficiary. However, in the meantime the above concerns still exist.

iii. Administrative Uncertainties:

- since RDSPs have only been available for a short time, and only with Bank of Montreal to date, questions as to their proper administration are likely to arise. Examples: What if the holder and beneficiary disagree on the request for a payment? Must the bank notify the holder prior to making a payment?

How to RDSPs affect ODSP benefits?

- amendments to the Ontario Disability Support Act are pending exempting assets held in, and withdrawals from, an RDSP. This is key!

How can Henson Trusts work with RDSPs?

- the will could authorize, but not require, the Trustee to make contributions to an RDSP and exonerate the Trustee from liability for choosing not to do so and thus not getting grants or bonds or tax deferral on the trust investments. The Trustee could probably make contributions in any event in his/her full discretion, but these provisions would provide some comfort to the Trustee.
- even if the parents want the bulk of their disabled child's inheritance to be directed to an RDSP on their passing it is preferable that it first flow into a Henson Trust, then the Trustee has flexibility, i.e., the child may have immediate capital needs such as to buy or lease a principal residence or vehicle, pay for moving expenses, etc. This might be particularly important where the child is living with the parents on their passing. This avoids possible grant and bond repayments being triggered if immediate payments from and RDSP are required to pay such expenses.

How is a plan established?

- contact your financial institution
- a friend at BMO Nesbitt Burns advises that BMO is the first bank to offer RDSPs and that plans can be set up by calling their call centre at 1-800-665-7700. BMO promotional material says that they had set up 3,000 across Canada by the end of January!

What is the deadline for 2008 grants?

- parents must make contributions by March 2, 2009 in order to receive a 2008 contribution from the federal government.

Summary:

1. Testamentary Henson Trusts should be considered by all parents of disabled children that are on ODSP or may later qualify for ODSP, so as to maximize government assistance and the amount of their estate that will eventually go to their family.
2. All parents of a severely disabled child should fully investigate the pros and cons of establishing an RDSP for government assisted savings for their child prior to opening a plan.
3. Where parents wish to leave substantial assets for the benefit of their disabled child it is preferable in my opinion that they draft their wills to include a Henson Trust vs. set up a large RDSP. By using a Henson Trust they control what happens to the funds on the child's passing vs. the assets flowing to the child's estate to be distributed either by their Will or on an intestacy. In addition, the Trustee appointed by the parents controls payouts to the child, not the child. So for control reasons, Henson Trusts are preferable in my view.
4. Probably the best plan is to set up an RDSP and wills with a Henson Trust that gives the Trustee authority to make contributions to an RDSP.
5. Until some of the legal issues that currently concern me have been addressed, I will not be recommending that my clients build up large sums in an RDSP.

Notes:

The above comments on RDSPs are a compilation from several sources, including a lecture I attended at the Canadian Bar Association Annual Institute on Estates and Trusts on Tuesday, Feb. 3, 2009 and are by no means exhaustive. I have not reviewed the Act or regulations.

I have not been directly involved in setting up an RDSP to date so have no personal knowledge of the banks' products nor how they implement the Act or regulations.

As the legislation and plans are so new and as there have been no court cases interpreting the laws it is impossible to predict exactly how the plans will function in all cases and situations. I anticipate amendments to the regulations from time to time and cases interpreting the language of the Act and regulations, all of which will hopefully provide clarity.

I recommend that you speak to a professional advisor knowledgeable about the plans, such as a financial advisor, accountant and/or lawyer, regarding the pros and cons of establishing an RDSP prior to doing so. They will not be right for every family.

I also recommend that you retain the services of a lawyer specializing in estates and trusts before preparing wills that include a Henson trust. Trusts are the most complicated area of my practice and are a minefield for the unwary lawyer.

I am pleased to offer potential clients a complementary one hour initial interview at which time I would be happy to discuss your situation and give a second opinion on your existing Wills and Henson Trusts.