



# DISABILITY ALERT

**DISABILITY ALERT** is a commentary on topics of current interest – usually topics relating to planning for individuals with disabilities and changes to current tax and social assistance legislation. Professional advice should be obtained before acting on any of this information. ed.8/15

## TRUSTS, TAXES AND DISABILITY

Most families should be using trusts in one way or another in their financial planning for a loved one with disabilities. When it comes this kind of planning, people automatically think of the Henson Trust to maximize social assistance. They believe it to be a unique arrangement that has legal characteristics different from all other trusts; but really that is not the case.

### WHAT IS A HENSON TRUST

The Henson trust came into being when Leonard Henson set up a trust for his daughter Audrey so that she could receive small amounts of income from the trust that would not limit her ability to claim financial assistance under the Ontario Disability Support Program (ODSP). Since only the trustees had authority to provide Audrey with trust distributions, the assets and income of the trust were not part of Audrey's assets or income that would determine her entitlement to income assistance. The trust is a kind of holding tank to provide income to Audrey on a managed basis.

A Henson trust is a discretionary trust just like other discretionary trusts used for other reasons. This means that the trustees have full discretion to control the trust assets and income distribution. Audrey had no rights in that regard. To repeat, a Henson trust is simply a discretionary trust utilized to maximize income assistance. Henson trusts or special needs trusts as they are sometimes called, can now be used in all provinces of Canada to maximize provincial income assistance.

## OTHER USES OF TRUSTS IN DISABILITY

Trusts can be utilized by families for reasons beyond the maximizing of income assistance. There are four main uses for trusts when it comes to disability and the related financial planning, tax planning and asset ownership. They are as follows:

- ❖ To maximize social assistance (Henson trust)
- ❖ To provide income to a person with disabilities
- ❖ To hold ownership of a property for a person with disabilities because they cannot or should not own property on their own.
- ❖ To allow the ownership of assets by family which might otherwise fall under the control of the Office of the Official Guardian.

The second, third and fourth points shown above are important uses beyond the Henson trust. They help families arrange their financial affairs over the long term despite the difficulties brought about by disability. The trust becomes the alter ego owner of property when personal ownership is not a good choice or even a possibility.

Trusts can also serve the same important functions when it comes to managing the personal finances of vulnerable people who may not have significant disabilities but nevertheless they cannot manage their personal finances. This is often overlooked.

## TRUSTS AND INCOME TAX

Without going into detail about the taxation of trusts, it can be simply said that trusts have many special rules in law and under the Income Tax Act which make them useful in handling the finances of a people with disabilities and vulnerable people.. In many cases, there is just no other way to do it.

Also, trusts provide a proper legal place for property ownership for these same individuals who can't or shouldn't own property because of his or her lack of legal competence or even the basic ability to make good judgments. Trusts also work well at the time of death of a person with disabilities to transfer the property of the trust to other family members on a tax free basis. A trust allows a mechanism to be put in place far in advance of events so decisions can be carried out when the moment arrives.

## TAX RATES FOR TRUSTS

Until recently, the Income Tax Act had two tax rates for trusts. One for trusts put in place during the lifetime of a person (inter vivos trust) and the other is for trusts set up in a will (testamentary trust). The two tax rate structures were as follows:

- ❖ Inter vivos trust - highest tax rate (one rate of 46%)
- ❖ Testamentary trust - graduated tax rate (rate between 20% and 46%)

However, all trusts can still hold many financial and tax planning benefits as money conduits despite their high tax rates.

## 2016 TAX RATE CHANGES FOR TRUSTS

The federal government believes that the graduated rates for testamentary trusts mentioned above are being used unfairly to create multiple trusts for several taxpayers and reducing overall income tax. Accordingly, the government will abolish the graduated rates for virtually all testamentary trusts starting in 2016. However, they have agreed to continue the graduated rates for trusts established for people with disabilities providing that the person qualifies for the disability tax credit. This new trust will be called a qualified disability trust (QDT).

Here are the important qualifications for a QDT. They will leave out vulnerable people who do not qualify for the DTC:

- ❖ At least one of the beneficiaries of the trust must qualify for the disability tax credit
- ❖ Only testamentary trusts will qualify as a QDT
- ❖ The trustee and the beneficiary with a disability (qualifying beneficiary) must jointly elect on an annual basis that the trust be a QDT
- ❖ There can only be one QDT for each person with a disability
- ❖ Existing testamentary trusts eligible for graduated tax rates will cease to be eligible for QDT status if they fail to qualify under the new rules outlined above

## QDT PROBLEMS

There are many problems with the new QDT rules for people with disabilities. The restrictions are very broad and often will make the QDT difficult to use. . Most certainly, people who are vulnerable but don't have a disability that makes them eligible for the disability tax credit will not qualify for QDT use.

The important restrictions on their use are as follows:

- ❖ The QDT rules are complex and will likely be beyond the understanding and affordability of many families. Tax filings and compliance will be complicated.
- ❖ Henson trusts that are in place now will not qualify as a QDT unless they are testamentary trusts and the electing beneficiary qualifies for the disability tax credit.
- ❖ Where the person with a disability has a mental challenge there will likely be a need for guardianship so an election for QDT can be made on their behalf.
- ❖ If different family members wish to establish a QDT, only one will be able to do so because only one QDT is allowed for each person with a disability.

This is a general overview of the use of trusts for people with disabilities. It touches on the important issues. Professional advice will be important.

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