



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.

DISABILITY – A LONG TERM FUNDING STRUCTURE FOR FAMILIES

Ever since I started working with personal finances and disability, I have and continue to be amazed that the planning is so often fragmented and lacks a sense of a well defined purpose. For example, Henson trusts are on everyone's list but the understanding of their many uses is often overlooked. People often open a Registered Disability Savings Account without identifying if the funds are really needed or whether the account may fall under the control of the Public Trustee some day.

What is more surprising is that few people do the math to see just how much capital is needed to fund the financial needs of a disabled loved one; where will the funds come from; how do the various income components work together? And so on.

As well, you can't properly plan the financial needs of a disabled loved one unless you first have a life plan. Do you want your loved one to live a lifestyle beyond what will be available from social assistance? If you can afford it and they are capable, do you want your loved one to live in their own home or with others who are disabled so families can pool their resources? Is your loved one's disability at a level that they must eventually live in an assisted care facility in which case little income support may be required. These are just a few of the questions that families should come to grips with before they embark on a long term financial structure for a disabled loved one.

A POSSIBLE FINANCIAL STRUCTURE

Having said that, let's look at a long term funding structure that I have worked with that could help you understand the moving parts and how it might be modified for your family's needs. It includes the use of a trust and a corporation which will take the funds out of mom and dad's estate and still allow some control by them. It puts the structure in place now and not years away through their wills so there is some element of an estate freeze in the plan.

Needed funds will be invested for a disabled loved one in a separate structure designed to allow flexible decision making by the family. In this case mom and dad's daughter, who we will call Jennifer, has a disability and is in her early 30s. She is legally competent and can

take care of her day to day needs and live on her own but has limited ability to earn income. She has two siblings at about her age.

Essentially what happens, as depicted in the attached diagram, is that mom and dad settle a Henson trust for Jennifer as well as incorporate an investment company that we will call Investco which the parents will control. They put their savings for Jennifer in Investco in return for Investco Special A shares. As settlors of a Henson trust they contribute funds to the trust to allow it to purchase a home (principal residence) for Jennifer. The trust will acquire Special C shares of Investco so it can participate in Investco dividends on a discretionary basis. Siblings will acquire Special D shares to allow them also to participate in dividends of Investco.

The share structure of Investco allows dividends to be paid to the Common shares, Special A shares, Special C, and Special D shares separately without paying dividends on other share classes. This provides significant flexibility with respect to the dividend distributions of Investco which is so important.

We have put values on the home and capital in Investco of \$300,000 and \$200,000 respectively but these amounts will depend on Jennifer's needs, local costs and availability of savings for Jennifer.

Let's look at a structure and some of the benefits that will come from it for Jennifer and her family.

FINANCIAL CONTROL AND FLEXIBILITY

Parents establishing a separate savings pool for their loved ones should have some control over the deployment of funds within the family as needs dictate and circumstances change. Often the loved one has a mental disability making it impossible for him or her to legally own property and this structure is mandatory. Even if this is not the case, putting in place a structure with lots of flexibility is important where a member of the family needs a hand up.

The structure shown has a separate pool of funds that should last long into the future. Mom and dad control Investco by owning Special B voting shares. All other shares are non voting. Mom and dad are also trustees of a Henson trust discussed below so they have a lot to say about how finances are deployed all the way around. In this structure, mom and dad are allowed to appoint replacement trustees for themselves in the Henson trust.

INVESTCO

Many of the characteristics of Investco are described elsewhere in this article. In addition to those characteristics, the following advantages are available:

- Siblings own the common shares of Investco and will ultimately benefit from the growth in the assets of Investco such as the home when Jennifer no longer needs them.

- Mom and dad can add to the funds of Investco when needed by Jennifer by subscribing for more Special A shares if necessary
- The Special A shares can be bequeathed to the siblings and redeemed on a tax free basis if funds are still available in the corporation once their purpose has been met.

HENSON TRUST

A Henson trust is commonly thought as a trust that is used to maximize social assistance but allows for additional limited income from family for the disabled person. However, most Henson trusts can have a variety of uses in disability and not just to maximize social assistance. The trust described in this article serves a few purposes such as owning a home, splitting income amongst family and preserving social assistance.

ESTABLISHING THE TRUST NOW, NOT LATER

Trusts established for a loved one with a disability are commonly contained in a will. The general reason for the delay is that trusts established before death (inter vivos) are subject to tax at the highest rate whereas progressive tax rates apply to trusts established in a will if they are qualified disability trusts.

The structure shown has included an inter vivos trust despite the high tax rates. These taxes can be mitigated by the preferred beneficiary election mentioned below and trust distributions to Jennifer. Putting assets in the trust also stops some of the growth of mom and dad's estate. In any case, the cost of income taxes should not stop planning for other good reasons.

In this case, mom and dad have the funds and want to get the structure in place now. Because they have the funds on hand to make it happen, they will enjoy tax and other benefits not otherwise available. Others may not be so fortunate and may wait to carry this out later in life - perhaps through their wills.

PREFERRED BENEFICIARY ELECTION

If a person with a disability is eligible for the disability tax credit, the trust and the disabled person can jointly elect each year to have trust income taxed on the tax return of the disabled person and not on the tax return of the trust. Personal exemptions of Jennifer and her low tax rates on dividends hopefully will result in no taxes payable by Jennifer if the election is made but in any event her tax rate will be much lower than that of the trust.

With careful planning the 50% tax rate of the trust may not be a problem or at least it is manageable. Consider that the trust income originating from the parent's capital contributions might have been taxed at that a very high rate to the parents anyways so little may be lost by the Henson trust.

Based on our review of the ODSP assistance rules in Ontario we do not believe the election to deem trust income to be personal income of Jennifer using the preferred beneficiary

election would not reduce social assistance. Jennifer is legally competent but if not she would not be able to sign the preferred beneficiary election and it would not be possible to use it.

TRUST OWNERSHIP OF PRINCIPAL RESIDENCE

Trusts can own a principal residence for one of its beneficiaries. Because it is in the plans of her parents to buy a home for Jennifer, they have decided to do it now and get the principal residence exemption through the trust. The trust can enjoy this exemption and eventually distribute the proceeds of the home to Jennifer's siblings on a tax free basis.

This makes sense with other siblings who as beneficiaries of the trust also will share the capital of the trust on the death of Jennifer. In the meantime, any gain on the home is tax free and executors of the trust will (within the terms of the trust) make the important trust decisions about the home and distributions and other matters. The tax benefit is huge. A home with a cost of \$300,000 as illustrated and held for thirty years by the trust would grow to \$500,000 – all tax free.

HOUSING COSTS

There will be a cost to maintain the home for Jennifer which she cannot afford to pay. In this case, the trust will pay these expenses.

CRA takes the view that such expenses paid by the trust are a taxable benefit, in this case to Jennifer. It is our belief that a taxable benefit does not give rise to income under Ontario ODSP social assistance rules but we do not know the situation in other provinces.

DEPENDANTS RELIEF LEGISLATION

Provincial dependant relief legislation may require a parents to provide a part of their estate to a person dependant on them. If not, someone such as the Public trustee or someone else may challenge the will and ask for a share on behalf of Jennifer. In Ontario, the Succession Reform Act is the operative law.

You should get experienced legal advice so that your structure has a less possibility of being challenged through such legislation.

PLANNING – ONE SIZE DOES NOT FIT ALL

Plans for a disabled loved one need to be tailored to each family's situation. The plan illustrated should work these parents who are in their early sixties with fairly high net worth. But your situation may be quite different so don't throw up your hands in despair. Work out a plan that works for you. ***Without planning, there is no plan.***

If you have an interest in this type of planning, do not attempt it without consulting professionals with income tax and legal experience in trusts and some knowledge of disability.

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