Advisory

Estate planning to benefit family members with special needs

According to a recent Statistics Canada survey, approximately one in seven Canadians over 15 years old experiences some type of disability, and this number is growing. Disabilities and special needs can take many forms, including developmental delays, learning and speech disabilities, sensory disabilities, and chronic conditions such as autism and Down's syndrome, and can range from mild to moderate to severe. Many people whose lives are affected by disability experience multiple disabilities rather than just one.

Where a family includes a member with special needs, the family's estate planning objectives will often include consideration of the unique circumstances and needs of that member. Below, we describe several estate planning ideas that may be relevant for a family member with special needs, with an emphasis on testamentary and *inter vivos* trusts and registered plans.

Planning for a family member with special needs should take into account his or her needs and circumstances including: the nature and extent of the special needs, his or her capacity to make decisions relating to property and personal care, and whether he or she relies (or it is expected will rely) on income-tested government programs for support.

The ideal plan for a particular family member will depend on his or her level of functioning and aptitudes, and whether his or her special needs are primarily mental, emotional or behavioural. For example:

- For a family member with severe autism, Down's Syndrome or developmental delays who requires additional assistance managing his or her affairs, or for a family member with schizophrenia, obsessive-compulsive tendencies or various psychological or behavioural issues who is capable of managing his or her affairs but is at risk, the estate plan to provide for him or her might incorporate a trust, including one established during lifetime and/or on death under one's will;

- For a family member with a severe physical disability affecting vision, speaking, hearing or mobility, who qualifies for the disability tax credit, the plan might incorporate establishment of and transfers to a registered disability savings plan; and

- For a family member with a physical infirmity, or a family member with Asperger's or Tourette's Syndrome who functions at a high level, is capable of managing property, and likely will be able to be financially self-sufficient, the plan might incorporate a gift of property outright under one's will or by joint ownership with right of survivorship.

A plan may utilize several appropriate strategies to meet the family member's anticipated needs. Important considerations are: whether the family member is expected to have or has the capacity to manage his or her own property, will be or is employable and financially self-sufficient, and will be or is able to make his or her own decisions concerning personal care. Additional protective measures may be required, such as ensuring the special needs family member has a power of attorney for property or personal care if capable of making one, or legal guardianship of him or her where an adult family member with special needs lacks the capacity to manage his or her own property or make personal care decisions at the relevant time.

Planning for the family member with special needs requires consideration of whether he or she is expected to rely on income-tested government support. For example, the Ontario Disability Support Program ("ODSP") provides qualifying low-income adults having a disability with income support and medical benefits in excess of the Ontario Health Insurance Program. To qualify for ODSP, a person must demonstrate financial need in respect of both income and assets, using relatively low thresholds, although certain income and assets are exempt for the purposes of qualifying for ODSP. However, non-exempt asset thresholds were increased in September of 2017, to $40,000 for an individual and $50,000 for a couple, and further exemptions and clarifications for existing exemptions were added, allowing for more flexibility for ODSP recipients. Qualifying individuals may be entitled to income support (for a single person with no spouse or dependants, approximately $1,169 per month) and medical benefits such as drug coverage, dental coverage, and certain medical supplies, as well as other special needs benefits. It is possible to plan gifts for an adult family member with special needs in a manner which best preserves his or her eligibility for ODSP benefits where this is considered desirable.

ESTATE PLANNING TECHNIQUES

Assets Held in a Testamentary or Inter Vivos Trust Including a "Henson" Trust

A trust is a relationship in which title to property is transferred to a person (the "trustee") who holds the property for the benefit of others (the "beneficiaries"). Typically, the terms of a trust are set out in a written trust agreement: for example, how the property is to be held and managed, and how, when and to whom it is to be distributed. A trust may be established during the transferor's (the "settlor's") lifetime (an "*inter vivos*" trust) or under a settlor's will (a "testamentary trust"), in which case it takes effect upon death. A trust set out in a will may also be funded with the proceeds of a life insurance policy or a registered plan such as a registered retirement savings plan ("RRSP").

A trust is a flexible and powerful planning tool. Its terms can be customized for various circumstances, and it is suitable for a special needs family member who requires additional assistance or protection in the management of his or her property: for example, because of severe autism, Down's Syndrome or developmental delays, or because of schizophrenia, obsessive-compulsive tendencies or various psychological or behavioural issues. If an adult family member is capable of participating in decisions, and it is appropriate and advantageous for him or her to do so, the trust terms can also facilitate the family member's involvement.

Inter vivos and testamentary trusts are considered separate taxpayers and are taxed at the highest marginal rate of tax on any income not payable or paid to a beneficiary in the year it is earned. It is possible to reduce the overall amount of tax owing with respect to income earned in a trust by "sprinkling" it among a group of beneficiaries who would then be taxed on the income at their own graduated tax rates.

However, in certain circumstances a "preferred beneficiary election" can be made by a trust which allows for the trust to deduct income accumulated on behalf of a beneficiary who is considered a "preferred beneficiary". A preferred beneficiary is an individual who is the settlor, spouse, former spouse, child, grandchild, or great-grandchild of the settlor who (1) is eligible for the disability tax credit, or (2) has attained at least age 18 and is a dependant of their spouse, parent or grandparent by reason of mental or physical infirmity, and does not have income that exceeds the basic personal amount for the year. With respect to an inter vivos trust, the effect of this election is that the trust can be taxed at the lower marginal tax rate of the beneficiary rather than the highest marginal rate of tax.

A testamentary trust, though, that qualifies as a "qualified disability trust" is taxed based on graduated tax rates, which allows income to be split between the trust and the beneficiaries. As well, since income retained in the trust will be taxed in a manner similar to

individuals (with a few differences), the incentive to pay out income in order to reduce overall taxes is reduced, which is helpful and provides flexibility as it is not always appropriate to pay income to a beneficiary.

To qualify as a qualified disability trust, a beneficiary eligible for the federal disability tax credit must elect with the trustees of the trust on the trust's tax return for the trust to be a qualified disability trust, subject to certain other conditions. While persons who are ineligible for the federal disability tax credit may be beneficiaries of the trust, "recovery tax" will be owing where such beneficiaries receive any capital distributions from the trust. It will also be owing where there are no longer any electing beneficiaries alive or where there is no longer an electing beneficiary who is eligible for the federal disability tax credit. Recovery tax claws-back the tax savings associated with the trust being taxed at graduated tax rates, as opposed to the highest marginal tax rate, in an attempt to prevent non-electing beneficiaries from benefiting from such favourable tax treatment.

Typical terms of a trust permit payments to a beneficiary from income and/or capital of the trust. Income earned in the trust may either be paid out or added to the capital of the trust. The trustee may have discretion as to the frequency and amounts of payments to be made for the benefit of the beneficiary. Where appropriate, the trust terms may provide for fixed annual or monthly payments to the beneficiary. The trust terms may also permit payments to third parties on behalf of the beneficiary or for loans to a beneficiary. Where appropriate, the terms of the trust may permit the beneficiary's participation in decision making about the trust assets and choice of trustees.

When planning a trust to benefit a family member with special needs, the trust must be drafted properly to meet one's objectives and the special needs family member's anticipated requirements. While the trust agreement may provide the trustees with broad discretion with respect to payments for the benefit of a family member, guiding principles for consideration by the trustees may be set out in a Letter of Wishes to assist the trustees in the exercise of their discretion. If a family member with possible special needs is young and it is not known what his or her future challenges may be, a broad discretion may be appropriate, with terms allowing for the trustees' ability to terminate the trust at an earlier time than the family member's death, should the protection of a trust not be necessary or otherwise advantageous, with guidelines set out in a companion Letter of Wishes with regard to one's wishes on these issues.

The use of a "Henson" trust has become popular in planning for family members with special needs, because it may permit generous payments to a family member without disentitling him or her to income-tested government assistance programs such as ODSP.

The term "Henson" trust is based on a case where this type of trust was employed.[1] A Henson trust is a discretionary trust which allows the trustees full discretion whether or not to make payments from income and capital to a beneficiary. The beneficiary must not have a vested right to receive income or capital from the trust. A Henson trust may be set up during one's lifetime or under one's will for the benefit of a special needs family member. Courts have held that a Henson trust is not an asset of the beneficiary for the purpose of social benefits such as ODSP because he or she is not legally entitled to enforce payments of income or capital from the trust. However, the treatment of Henson trusts in Canadian provinces other than Ontario may differ in this regard.

Beneficial interests in assets held in inheritance trusts and life insurance trusts are generally permissible for ODSP recipients, provided these are available to be used for the recipient's maintenance and the total trust capital available to the recipient from one or more such trusts (together with the cash surrender value of any life insurance policies which the recipient has) remains below $100,000. The capital of the trust must be derived from an inheritance or from life insurance policy proceeds. If the family member relies on ODSP, payments from such a trust can be made for approved disability-related items or services and approved education or training expenses incurred because of a disability which are not reimbursed, and for other expenses within the allowable limits. The amount that can be paid out (other than for disability-related items, services, training or education that has been approved in advance) without jeopardizing ODSP is only $10,000 in any twelve-month period, subject to reductions for other amounts received such as gifts or voluntary payments. Income from the trust may be capitalized without being considered income for the purpose of ODSP so long as the $100,000 limit on trust capital is not reached.

Registered Disability Savings Plans

A family member with special needs who qualifies for the federal disability tax credit (for example, being visually impaired or having a severe physical disability affecting speaking, hearing or mobility which markedly restricts the basic activities of daily living) may qualify to have a registered disability savings plan ("RDSP") held for him or her as a beneficiary. An RDSP provides a tax-assisted way to plan long-term for ongoing future payments for the family member. A parent or guardian of the family member with special needs or certain others may open an RDSP for the family member.

A limited amount may be contributed to a beneficiary's RDSP on a lifetime basis, currently up to $200,000. Investment income earned in the plan is tax-free, and payments out of the plan are partially taxable. Income-tested government assistance may be available to match

[1] *Ontario (Ministry of Community and Social Services) v. Henson* (1987), 28 E.T.R. 121 (Div. Ct.), affirmed (1989), 36 E.T.R. 192 (Ont. C.A.).

or enhance contributions to the plan. In addition, a parent or grandparent of a financially dependent child or grandchild who qualifies for an RDSP may rollover funds on death from certain registered plans into an RDSP for the child or grandchild.

An RDSP is a long-term savings vehicle which provides lifetime financial assistance to the beneficiary, typically in later life. Generally, to optimize benefits, savings should be held in the plan for at least ten years, although an exception may apply for a beneficiary with a shortened life expectancy. RDSP income must be paid out beginning in the year the beneficiary turns 60 at the latest, and can be paid to the beneficiary or to his or her estate, subject to certain restrictions.

When choosing whether to provide for a family member with special needs by way of an RDSP, a parent should consider whether the family member is capable of making a will, or to whom any remaining proceeds of an RDSP plan would otherwise flow on an intestacy. For the purpose of ODSP, an RDSP is an exempt asset and RDSP payments exempt income; however, a beneficiary must include in his or her income certain funds transferred to his or her RDSP, in particular, funds transferred from certain registered plans to the RDSP.

A parent or grandparent may be able to make a tax advantageous gift upon death from his or her RRSP, Registered Retirement Income Fund ("RRIF"), or Registered Pension Plan ("RPP") for the benefit of a family member with special needs. Rollovers are also available from these registered plans to an RDSP of a dependent infirm child or grandchild, provided certain requirements are met. Among other requirements, there must be available contribution room in the child's or grandchild's RDSP and the child or grandchild must have been financially dependent on the deceased for support at the time of death due to a physical or mental infirmity. To qualify as financially dependent, typically, the child or grandchild's annual income for the preceding year may not exceed a specified amount (approximately $12,069, indexed for inflation after 2010). Generally, the rolled-over funds are taxed upon being paid out from the RDSP.

Outright Gift By Will

An individual may provide for a family member by an outright gift of property such as assets or money made under his or her will. An outright gift by will may be suitable where the family member has a physical infirmity, or has Asperger's or Tourette's syndrome and functions at a high level. It is typically appropriate where the family member is an adult with full capacity to manage property who is not relying on income-tested government income supports such as ODSP. The family member receives the property immediately upon the estate being administered, and may use it as he or she wishes.

However, in many situations, an outright gift by will may not be appropriate. For example, monies gifted by will to a mentally incapable adult may have to be paid into court for his or her account or to such person's guardian of property, subject to certain exceptions.

Receiving a gift outright under a will, even of a small amount, may jeopardize receipt of ODSP, depending upon the size of the gift and whether it is considered an exempt asset or is included in income for the purpose of ODSP. As noted above, the ODSP asset limit for a single person is now $40,000, exclusive of exempt assets. The exempt amount that can be received without being included in income is currently $10,000, in any twelve-month period and includes various payments, notably gifts and payments from trusts. An additional exemption, discussed above, may apply to amounts up to $100,000 held in one or more trusts where the trust capital was derived from an inheritance or a life insurance policy. Such a trust may be established in a will, in which case it forms an exempt asset and is not included in income, or by the ODSP recipient within six months of receiving an inheritance, in which case it may form an exempt asset. Although a principal residence is generally an exempt asset, and a gift used to purchase a primary residence or a vehicle or for first and last month's rent is now specifically exempt from the calculation of an individual's income, receipt of income to pay expenses for the residence could result in loss of ODSP eligibility.

Jointly Held Assets

If assets are held "jointly with right of survivorship", generally, upon the death of the first joint owner to die assets pass to the surviving joint owner outside the estate by the nature of the legal title. While both co-owners are living, each can use and in part control the asset.

Accordingly, an individual may transfer property so that it is held jointly with right of survivorship with a family member with special needs, so that the property passes to that family member upon the individual's death. Like an outright gift, jointly held assets may be suitable where the family member has a physical infirmity, or has Asperger's or Tourette's syndrome and functions at a high level. This strategy is typically appropriate where the family member is over the age of majority and capable of managing property, and does not rely on income-tested government support. The family member should also be financially responsible, as he or she will receive partial control over the asset prior to the individual's death.

Care must be taken to properly plan and document the transfer into joint ownership in order to evidence the individual's intention to give the property to the family member with special needs. An important consideration is that such a transfer may have tax

consequences resulting in a capital gain being triggered and resulting tax and it is important that professional advice be sought prior to any such transfer.

Planning Options for Registered Plans

While generally the value of a registered plan must be included when calculating a deceased taxpayer's income for their year of death, there are certain exceptions, some of which apply when a registered plan is left for the benefit of a disabled dependent. The registered plan can be left outright to a spouse who can roll it over into the spouse's own registered plan. If the spouse is disabled, the funds can be used for the spouse's benefit as discussed below, by use of a lifetime benefit trust, as well as being available for a non-disabled spouse's retirement. The registered plan can also be used to purchase an eligible annuity for a minor child of the deceased, which may be of benefit where the child is also disabled, or a lifetime benefit trust can be used, as discussed below.

For disabled dependents, a deceased's registered plan can be transferred tax-free into an RDSP (discussed above) or RRSP for the dependent. Another option is to use the plan to purchase a qualifying trust annuity. This type of annuity, which is subject to specific rules, must be held by a lifetime benefit trust for the disabled individual who is a spouse, common-law partner, child or dependent grandchild of the deceased. The beneficiary of the lifetime benefit trust must have a mental infirmity, meaning the person must be dependent on another for care for a considerable period of time, and their dependency must arise from the mental infirmity.

These planning options can be combined with the others discussed in this Advisory to allow for discretion to be given to an executor or trustee to choose the best option for the disabled beneficiary, while minimizing income tax for the deceased's estate to the extent possible. Often it will not be clear what the best option will be until after death of the individual, so allowing discretion in this manner is often the best planning.

OTHER PLANNING TECHNIQUES

Custody and Guardianship of Minors

Where the family member with special needs is a minor child, his or her parent or legal guardian may wish to provide in a will for custody of the child’s person and guardianship of the child’s property should the parent be unable to care for him or her. It is important to consult with the prospective custodian(s) and guardian(s) to ensure that they are agreeable to taking on the role. The appointment of a custodian or guardian by will lasts for ninety days after the death of the testator, and may be extended to a permanent appointment by court application, subject to the discretion of the court. The will may also provide for

payments to the guardian on behalf of the minor, including in respect of any expenses occasioned by the custody and guardianship. Parents may also wish to outline using a Letter of Wishes guidelines to assist the guardians in their care and custody of the family member with special needs to better inform them on a myriad of personal care issues of which they need to be aware. As well, they may also wish to indicate that steps be taken upon the child's attaining majority for an application to be made for guardianship of property and for personal care.

Powers of Attorney and Guardianship of Adults

Conversely, where the family member with special needs is an adult and mentally capable, it is strongly recommended that he or she create powers of attorney for property or personal care in order to permit others to manage property or personal decisions on her behalf should this be required in future.

A power of attorney is a legal document that can permit someone (an "attorney") to make decisions on behalf of another person (the "grantor"). In Ontario, there are two types of powers of attorney: for property and for personal care. The powers granted under each may be either general or limited in scope. The *Substitute Decisions Act* (Ontario) sets out the legislative framework for powers of attorney, including the rights and obligations relating to them.

A Continuing Power of Attorney for Property ("CPAP") permits the attorney to manage property, including assets and financial affairs, on behalf of the grantor, even after the grantor becomes unable to make these decisions for himself or herself. A person must be eighteen years of age and mentally capable to grant a CPAP. Although the CPAP takes effect immediately upon execution, it may be safely stored until the need to use it arises according to a written Direction. In managing property for the grantor, an attorney for property must act diligently and in good faith.

Where a person lacks the capacity to grant a power of attorney or to manage property, an application under the *Substitute Decisions Act, 1992* (Ontario) for the appointment of a guardian of property may be an alternative. However, court appointment of a guardian is time-consuming and intrusive and is generally not recommended where a power of attorney is a suitable alternative. In certain cases, depending on the nature of the family member's situation and medical condition and special needs, a guardianship may be more suitable as a permanent solution given a power of attorney can always be revoked by the person who made it. Like a trust, a power of attorney or guardianship for property permits another person to assist the family member with special needs in managing his or her property. A power of attorney or guardianship for property may be especially useful where

the family member already has title to property or where he or she expects to receive an outright inheritance from a relative.

A Power of Attorney for Personal Care ("PAPC") permits an attorney to make personal care decisions on the grantor's behalf, i.e., decisions relating to health care, nutrition, shelter, clothing, hygiene and safety, should the grantor become incapable of making such decisions. The grantor must be sixteen years or older, be able to understand whether the proposed attorney has genuine concern and appreciate that the proposed attorney will make decisions for him or her. Unlike a CPAP, a PAPC takes effect only upon the grantor's incapacity to make personal care decisions. In making personal care decisions, an attorney for personal care must act diligently and in good faith, taking into account any specific wishes or instructions the grantor expressed while capable. The grantor may set out his or her wishes formally in a letter written for that purpose. Where a person lacks the capacity to grant a PAPC or is not capable of making personal care decisions, a court-appointed guardian of the person may be an option.

Letters of Wishes

We have already mentioned several circumstances in which an individual seeking to benefit a family member with special needs may desire to set out his or her wishes in written form. A Letter of Wishes is a formal document often drafted with the assistance of a lawyer. Where broad legal powers are granted to the trustee of a trust or pursuant to a power of attorney, a Letter of Wishes can provide guidelines to the trustee or attorney in exercising those powers. A Letter of Wishes from a parent to a child's guardian(s) may also set out the guiding values and principles for the child's care and upbringing. While a Letter of Wishes is typically not legally binding, it can be an effective method of communicating goals and values and critical information.

CONCLUSION

We have introduced a variety of planning ideas and options which may be appropriate for a family that includes a family member with special needs. We have discussed various approaches for safeguarding property interests for the family member, and facilitating his or her life transitions in order to provide a better quality of life for him or her. As mentioned at the outset, planning for a family member with special needs should take into account the family member's needs and circumstances including age, capacity, and whether he or she relies or expects to rely on income-tested government programs for support. Because every situation is unique, individual professional advice should be obtained to tailor your estate planning to your family's particular circumstances.

The comments offered in this Client Advisory are meant to be general in nature, are limited to Ontario law and are not intended to provide legal advice on any individual situation. Before taking any action involving your individual situation, you should seek legal advice to ensure it is appropriate to your personal circumstances.