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Tax & Estate

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 ensure 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 (CPP) disability benefits, for example, are available to people who meet the plan's disability and contribution requirements. The disability must be both:

- severe – where a person is incapable of regularly pursuing any substantially gainful occupation; and
- prolonged – the disability is long-term and of indefinite duration or is likely to result in death.

The 2014 maximum monthly disability benefit a qualifying person can receive is $1,236.35, plus a maximum monthly benefit of $230.72 for each dependent child of a disabled contributor. These are related but separate applications that must be made using forms available through Service Canada.

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 workers' 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 an inheritance.

Public disability benefits, such as CPP and Employment Insurance disability benefits, are generally taxable. 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.

Federal and provincial support programs

As part of the Child Disability Benefit (CDB), the federal government will pay as much as $220.83 (for the period of July 2014 to June 2015) per child each month to families with children qualifying for the disability tax credit (DTC) based on family net income. Tax form T2201: *Disability Tax Credit Certificate* must be completed and approved by the Canada Revenue Agency (CRA) in order to qualify, and the payment is then delivered as part of the monthly Canada Child Tax Benefit (CCTB) payment. (See below for more about the DTC.)

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, the Ontario Disability Support Program (ODSP) 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 calculation while other provinces do not. On a single-person basis, maximum annual direct support ranges from under $10,000 to just under $20,000.

Government tax credits and deductions

Tax measures commonly available to assist persons with disabilities generally fall into three categories:

- Deductions: Qualifying items reduce the taxable income upon which relevant federal and provincial tax rates are applied to arrive at initial tax liability
- Non-refundable tax credits: Once tax liability is calculated, these credits directly reduce that liability but cannot take it below zero. The qualifying amount is multiplied by the applicable federal or provincial rate (usually the lowest bracket rate) to arrive at the credit value. The federal rate is 15%
- Refundable tax credits: These may result in an amount payable to the individual even when tax liability has been reduced to zero

The following is an outline of the key items and their potential dollar values (often income-dependent), though it does not cover all possibilities. For a comprehensive view, including detailed qualification criteria, consult Guide RC4064: *Medical and Disability-Related Information*, available through the CRA website.

Disability tax credit (DTC)
This is a non-refundable credit, available both federally and provincially. Using CRA Form T2201: *Disability Tax Credit Certificate*, the disability must be certified by a qualified medical practitioner as being both severe and prolonged:

- Severe: Blindness; conditions requiring life-sustaining therapy; a marked restriction in speaking or hearing, walking, feeding, dressing; or elimination or a marked restriction in everyday mental functions
- Prolonged: Lasting, or expected to last, continuously for at least 12 months

The 2015 basic federal amount of the DTC is $7,899. A supplement worth as much as $4,607 may be available for children under age 18, though the value is reduced if certain child and attendant care expenses are claimed for the child. Taken together, the maximum possible federal DTC is $1,875.90.

Medical expense credit
An individual may claim eligible medical expenses paid, whether incurred in Canada or elsewhere, in any 12-month period. Special rules apply to attendant care expenses, whether the care was received at home or in a care facility.

This is a non-refundable tax credit, equal to expenses that exceed the lesser of (for 2015):

- $2,208 (indexed annually), or
- 3% of disabled individual's net income.

Eligible expenditures can be claimed either under this medical expense credit calculation or as a disability support deduction, but not both. Accordingly, a test calculation should be run to determine which way yields the best net tax result.

Disability supports deduction
A disabled individual may deduct qualifying, out-of-pocket expenses incurred to work, go to school, or conduct grant-supported research. The individual may not deduct amounts already claimed under the medical expense credit (whether claimed by the individual personally or on his or her behalf as a dependant), or amounts already reimbursed by health insurance plans or through other non-taxable payments.

Generally, the deduction cannot exceed the person's earned income for the year, calculated using CRA Form T929: *Disability Supports Deduction*.

Refundable medical expense supplement
This is a refundable credit designed to assist people with very low incomes who claim either the disability supports deduction or the medical expense credit. Subject to a clawback where family net income exceeds (for 2015) $25,939, this federal credit can be worth as much as $1,172.

Caregiver amount
This non-refundable credit is designed for individuals providing in-home care to an immediate family member or certain close relatives. If this credit is claimed by anyone, the infirm dependant 18 or older credit (which is of equal value) may not be claimed. Furthermore, this credit is reduced when the eligible dependant credit is claimed for the same live-in person.

The 2015 federal reference amount is $4,608, allowing for a credit of up to $691.20.

Family caregiver credit
This non-refundable federal credit may be claimed as an enhancement to certain dependency-related credits, where the dependency is due to mental or physical infirmity:

- Spouse or common-law partner credit
- Child credit
- Eligible dependant credit
- Caregiver credit

The 2015 credit is based on a reference amount of $2,093, for a potential value of $313.95.

Child care expenses

The calculation of this credit can be complicated, even without disability issues to consider. For present purposes, be aware that there are provisions to guard against double counting where concurrent claims are made for the DTC or the medical expense credit.

Children's arts tax credit

This non-refundable federal credit allows for a credit claim of $500 spent on eligible expenses for a child. For disabled children, the eligible amount parents can claim is doubled to $1,000, making the credit worth as much as $150.

Children's fitness tax credit

For 2014, this is a non-refundable credit for a claim of $1,000 spent on eligible expenses for a child. For disabled children, the eligible amount parents can claim is an additional $500, making the credit worth as much as $225.

A proposal was announced in October of 2014 to convert this credit from non-refundable to refundable beginning with the 2015 taxation year and for subsequent years.

Transferred amounts

An individual may be able to claim certain amounts, notably the DTC and the medical expense credit, transferred from a spouse, common-law partner or dependant.

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 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.

Why trusts can be an option

For more information on alter ego and joint partner trusts, please see our *Tax & Estate InfoPage* titled *Tax planning using alter ego and joint partner trusts*.

There are many benefits to including trusts in your estate plan, including control, reduced taxation and the potential for the disabled beneficiary to retain his or her 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 a trust may reduce probate taxes payable upon your death as the assets may pass outside of your estate. Generally, property is deemed as disposed of when it is transferred into a trust, resulting in immediate tax implications to the settlor. 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 common-law partner) are generally deemed to dispose of their capital property every 21 years. This 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.

Think carefully about who will act as trustee of any trust you establish. Keep in mind that if you expect the trust to run for a lifetime, then a corporate trustee 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, common-law partner, child, grandchild or great-grandchild of the settlor) must qualify for the DTC. Alternatively, the preferred beneficiary must be 18 years of age and dependent on another person because of mental or physical infirmity and the beneficiary's income must not exceed the basic personal amount ($11,327 for 2015). 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)

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. 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 includes 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 disabled beneficiary is incapable of preparing his or her own Will, in which case the intestacy rules would generally apply upon the beneficiary's death to assets left to the individual directly.

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 the 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.

2014 Federal Budget amendments to taxation of testamentary trusts

Although testamentary trusts are currently subject to graduated tax rates, the 2014 Federal Budget introduced a top-bracket-rate taxation regime on every dollar of income for testamentary trusts for taxation years after 2015.

Graduated rate estates and qualified disability trusts will continue to be taxed at graduated rates. An estate that arose as a consequence of death and that is a testamentary trust will be subject to graduated rate taxation for the first 36 months of its existence. Qualified disability trusts will be exempt from the top-bracket-rate taxation. A qualified disability trust is a trust that is a resident of Canada, arose as a consequence of death and has jointly elected in its annual tax return with its DTC-eligible beneficiary. Therefore, testamentary trusts that were settled for disabled beneficiaries may continue to enjoy the benefits of graduated tax rates.

Registered Disability Savings Plan (RDSP)

The RDSP came into effect on January 1, 2008, and is a registered investment plan intended to encourage long-term savings for persons with disabilities. The plan is modelled after registered education savings plans (RESPs) and their grant and bond incentive programs. RDSP contributions are not tax deductible, and government grants and bonds are deposited directly into the plan tax-free. Depending on the results of an income test, grants can be up to 300% of personal contributions, and bonds can be obtained without making any personal contributions. While there are no annual contribution limits, there is a lifetime RDSP contribution limit of $200,000, which can be made up to and including the year in which the beneficiary turns 59 years of age. Once the beneficiary turns 60 years of age, mandatory payments are required. Earnings and growth generated within the RDSP remain tax-deferred until payments to the RDSP beneficiary are made, with this individual the only person entitled to receive payments from the plan.

Generally, to establish an RDSP, the beneficiary must be a Canadian resident with a valid Social Insurance Number, and must qualify for the DTC in the year of establishment and in each following year. Where the RDSP beneficiary does not qualify for the DTC, the RDSP must generally be collapsed. However, special considerations allow an RDSP to remain open in a situation where, after the plan is established, the beneficiary does not qualify for the DTC in a particular year but then re-qualifies for this tax credit in the foreseeable future. Additionally, the RDSP rules have been amended in recent years to allow for a deceased parent's registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) proceeds to fund an RDSP. To some degree, this alleviates a parent from having to make an either/or decision about choosing to fund his or her RRSP or a child's RDSP, since proceeds from the former may now make their way into the latter.

For more information, please see our *Tax & Estate InfoPage* titled "Death and taxes."

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 a financially dependent child or grandchild.

The value of the RRSP or RRIF upon your death will be taxable to the beneficiary spouse, common-law partner who can generally offset the income by transferring the amount into his or her 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 a designated benefit to a beneficiary who is a financially dependent child or grandchild.

A disabled (grand)child will generally be considered financially dependent if his or her net income in the previous year does not exceed the basic personal amount ($11,138[†]) plus the disability amount ($7,766[†]), for a maximum income of $18,904 in the year preceding the year of death.[†] If your beneficiary is financially dependent and disabled, then he or she may transfer the refund of premiums into his or her own RRSP or RRIF to maintain the tax-deferred status of the funds. Probate taxes may be payable in some provinces on the proceeds of the RRSP or RRIF that flow through the estate.

Lifetime benefit trusts

Another alternative is to have the RRSP or RRIF proceeds settled into a testamentary trust at the time of your death. These proceeds may be settled into a testamentary trust on a tax-deferred basis provided that the trust is a lifetime benefit trust and the proceeds are used to acquire a qualifying trust annuity. A lifetime benefit trust is settled upon the death of the spouse or common-law partner of the mentally infirm beneficiary, or the (grand)parent of whom the mentally infirm beneficiary was dependent on for support. Only the mentally infirm beneficiary is entitled to the capital and income of the trust during his or her lifetime. Further, the trustees must have the ability and discretion to distribute capital and income to the beneficiary while considering his or her need for comfort, care, and maintenance. If a Henson trust meets these conditions, a tax-deferred rollover of the refund of premiums into the trust can occur.

Rollover to an RDSP

Similar to the rollover provisions under the refund or premiums and designated benefits option discussed above, it is possible to facilitate a tax-deferred rollover of RRSP or RRIF proceeds to an RDSP as a result of the annuitant's death. To qualify for the rollover, the beneficiary of the RDSP must have been the child or grandchild of the deceased annuitant and financially dependent on the deceased annuitant by reason of mental or physical infirmity. The rollover limit is the lesser of the total of all refund of premiums payments received by the individual and the individual's remaining RDSP contribution room. Rollover amounts will be treated as private contributions, reducing the RDSP contribution room available, but will not attract the Canada Disability Savings Grant. Also note, the Accumulated Income Payments from an RESP may also be rolled over into an RDSP under the condition that both plans have a common beneficiary. Additionally, generally one of the following conditions must be met in order to facilitate the rollover:

- The beneficiary has a severe and prolonged mental impairment that can reasonably be expected to prevent the beneficiary from pursuing post-secondary education
- The RESP has been in existence for at least 10 years, and each beneficiary is at least 21 years of age and is not pursuing post-secondary education
- The RESP has been in existence for more than 35 years

[†]2014 values, for deaths occurring in 2015, indexed annually

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, 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.

For more information on substitute decision making, please refer to our *Tax & Estate InfoPage* titled "Incapacity – planning ahead helps."

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 (or mandate in Quebec). 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 yourself. 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. 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.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at www.invesco.ca.

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