

Leaving an inheritance to a person with disabilities – Henson trusts and other considerations

If you would like to leave some money or assets to a loved one who is living with disabilities when you die, be sure to consider how receiving that inheritance might impact that person's other financial resources, such as government social assistance benefits.

In this article we will discuss:

- 1 Henson Trusts
- 2 Qualifying Disability Trusts (QDTs)
- 3 Estate planning considerations
- 4 Registered Disability Savings Plans (RDSPs)

Henson trusts can protect access to social assistance benefits

Every province and territory has its own specific laws and regulations addressing social assistance and support programs, and most have programs directed solely at persons with disabilities. The benefits provided can include a monthly stipend, specialized or subsidized housing, and/or medical benefits. In order to qualify for this assistance, the person must show that they are “disabled”, and that they are in “need”, as defined in the applicable legislation.

In general, a person will not be considered in “need”, and therefore will not be eligible to receive disability social assistance, unless the person meets certain asset and income tests. If the person inherits a significant sum of money directly (as opposed to indirectly, as the beneficiary of a trust), the inheritance could disqualify the person from receiving continued social assistance.

In most provinces and territories, if an inheritance is payable to a trust for the person with disabilities instead of directly to that person, and the terms of the trust are sufficiently “discretionary”, the assets within the trust will not be considered to be assets of the person with disabilities. Accordingly, the inheritance within the trust will not affect such person's entitlement to government social assistance programs. The trust may also permit the trustee to distribute certain annual amounts to the beneficiary where such distributions remain below the beneficiary's income limit for receiving social assistance.

As a result, if one of your intended beneficiaries is receiving social assistance benefits, it is usually best to leave assets to that person through a fully discretionary trust, sometimes referred to as a “Henson” trust, instead of leaving assets directly to that person. This is a type of trust where the trustee manages the assets for the benefit of the beneficiary, but the assets are not legally owned by the beneficiary, and the trustee has the complete discretion to determine if, when and how much should be distributed to the beneficiary at any given time.

Henson trusts are useful even if social assistance benefits are not a concern

Even if the beneficiary with disabilities is not currently receiving social assistance benefits and does not expect to receive them in the future, or resides in a province or territory where discretionary trusts do not provide significant protection from an asset or income test, there may be other reasons to use a discretionary trust for that person's inheritance. For example, if you want to leave assets to a beneficiary with disabilities who is still a minor, or who is mentally impaired, or financially irresponsible, then using a trust will allow you to appoint someone (a trustee) who will manage that inheritance. If the person with disabilities is very dependent on caregivers, the person might be vulnerable to financial abuse; appointing a trustee to manage their inheritance may help to reduce instances of financial abuse. Further, using a discretionary trust may protect the assets within the trust from claims by a creditor or separated spouse. (Ask your IG Advisor for a copy of our article, #2217, "Leaving an inheritance to a financially irresponsible person: Why using a testamentary spendthrift trust may be right for you".)

How do testamentary trusts work?

When you die, the assets in your estate are distributed as follows:

- if you have a will, then by the terms of your will, or
- if you do not have a will, then by the "intestate succession" rules of the province or territory in which you are resident at the time that you die.

If you write a will, then you can specify that a particular person's interest in your estate will be held in trust for them under the terms and conditions that you create. The person you name as trustee will have legal ownership over the trust assets, but will maintain those assets for the benefit of the primary beneficiary in accordance with the terms of the trust. The trust does not come into force until after you have died.

Typical terms in a Henson trust

If your will creates a Henson trust, then expect to see clauses in your will that note the following:

- The trustee has complete discretion to decide if, when, and how much to pay from the trust income and the trust capital to the beneficiary with disabilities (the "primary beneficiary").
- The trust describes who will receive what remains of the trust property upon the death of the primary beneficiary (the "residual beneficiaries"). The residual beneficiaries could be the spouse, children or other descendants of the primary beneficiary (if any such persons exist), other family members, friends, a charity, or the remaining residual beneficiaries of your estate.

“The trustee of the Henson trust does not have to be the same person that you appointed as the personal representative of your estate, but it can be.”

- The trustee has the authority to deviate from the “even hand” rule that usually binds trustees, so that the trustee can make decisions that benefit the primary beneficiary at the expense of the residual beneficiaries, even to the extent of potentially distributing all the trust capital to the primary beneficiary, if the trustee thinks it appropriate.
- The primary beneficiary has no vested rights in any of the trust income or capital.
- The trustee may be given the express authority to wind up the trust and distribute all the accumulated trust capital to the primary beneficiary if the trustee thinks it reasonable to do so. For example, if in the trustee’s opinion a trust is no longer required because the primary beneficiary is no longer disabled or receiving social assistance, then it might be reasonable to wind up the trust and distribute all assets to the primary beneficiary outright.
- The trustee may also be given the express authority to use the accumulated trust capital to provide the funds for the primary beneficiary to purchase an annuity contract on such terms as the trustee considers reasonable. For example, if the trustee finds that it has become burdensome to maintain the trust, it might be reasonable to wind up the trust.

Who should be the trustee of a Henson trust?

The trustee of the Henson trust you establish in your will does not have to be the same person that you appointed as the personal representative of your estate¹, but it can be. What is important is that the trustee must not be the primary beneficiary.

Remember that the trust is designed to last for the lifetime of the primary beneficiary – this could be several decades. When appointing the trustee of this trust, you should consider appointing alternate trustees, in case the person you chose as primary trustee dies, resigns, or loses capacity before the trust has been wound up. The persons you choose as primary and alternate trustees should be mentally capable adults who are willing and able to act, who are trustworthy, and who have a relationship with the primary beneficiary or are willing to develop that relationship. Ideally, the trustees should reside in the same province or territory as the primary beneficiary.

For Quebec residents, trusts under the *Civil Code of Quebec* require an independent trustee. For testamentary trusts, essentially this means that there must be at least one trustee who is not a beneficiary).

If you do not know of anyone who might be able to act as trustee, consider appointing a licensed trust company as a corporate trustee.

¹ In most of Canada, the personal representative of an estate is called the executor or administrator. In Quebec, the legal term is liquidator. In Ontario, the term is estate trustee. While executor remains a very commonly used term across the country (other than Quebec), for simplicity, personal representative is used in this report.

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What are qualifying disability trusts (QDTs)?

A qualifying disability trust (QDT) is a type of trust that meets certain conditions set out in the *Income Tax Act* (Canada). Generally speaking, if a trust generates income that it is not paid or made payable to a trust beneficiary, that income is generally taxable to the trust at the top marginal tax rate for individuals in that province or territory. A trust that is also a QDT can have its income taxed at the same graduated rates of tax as are available to individuals. Among other things, to be a QDT:

- the trust must be testamentary (i.e., created as a consequence of the death of the will-maker, typically by the terms of the will-maker's will),
- at least one of the beneficiaries of the trust must:
 - qualify for the federal disability tax credit,
 - be specifically named as a beneficiary of the trust in the will, and
 - not already be the beneficiary of a different QDT, and
- the disabled beneficiary of the trust and the trustee of the trust must make a joint election with the Canada Revenue Agency to treat the trust as a QDT.

Depending on your province or territory, it may be possible for a particular trust to be a “Henson” trust and a QDT at the same time. Speak to your IG Advisor and/or legal advisor about whether Henson trusts and/or QDTs have a place in your estate plan.

Costs of a testamentary Henson trust and/or QDT

Some financial costs associated with a trust in a will include:

- **Legal fees:** Your lawyer or notary may charge fees to create the trust in your will.
- **Accounting fees:** The trust will in general be considered a separate taxpayer and required to file an annual T3 trust tax return and T3- tax slips with the Canada Revenue Agency, and the trust may incur accounting fees associated with preparing those filings. For residents of Quebec, a trust income tax return TP-646-V and Releve-16 slips (“Trust income”) also need to be filed. If the trust owns real estate, it may also be required to file returns pursuant to the federal *Underused Housing Tax Act*. Other returns may be required depending on the case.
- **Trustee fees:** Trustees are entitled to reasonable compensation for work done. Normally in Quebec, trustee compensation is addressed in the will, but this is not necessarily the case in the rest of Canada. Often if the trustee is a family member, the trustee may choose not to charge a fee, but if the trustee experiences a lot of stress because the primary beneficiary is frequently badgering the trustee for money, then a trustee who might ordinarily have waived their fee may start charging a fee for their troubles.
- **Probate fees²:** You must ensure that sufficient assets are paid into your estate so that the trust in your will can be funded. This will mean paying probate fees on the assets in your estate.

² Probate fees are referred to as “estate administration taxes” in Ontario. These fees will not apply in Quebec. The amount of probate fees that may apply will vary between provinces and territories. Ask your IG Advisor what the rates are in your jurisdiction.

- **Fees associated with passing accounts:** Depending on the case, your trustee may be required to “pass their accounts” with the courts on a regular basis and/or upon the wind-up of the trust, to demonstrate how the trustee managed the trust property. There may be legal and accounting costs associated with that passing of accounts.

Other non-financial costs may include:

- **Dealing with a difficult beneficiary:** Sometimes the primary beneficiary may not appreciate the fact that “their” inheritance was set aside in a trust instead of being paid directly to them. The trustee may receive frequent and demanding calls from the primary beneficiary who is seeking “their” money, and the trustee may find that their patience is tried.
- **Strain on the personal relationship between the trustee and the primary beneficiary:** Even if the primary beneficiary is appreciative of the reasons for the trust, putting someone else in control of “their” inheritance may cause a previously cordial relationship to deteriorate. The trustee might find themselves less willing to “say no” even though the trustee thinks a distribution would not be in the primary beneficiary’s interests, because the trustee does not want to further hamper the relationship.

These last issues could be dealt with by appointing a licensed trust company as a corporate trustee. As a neutral party, they should be better positioned to “say no”.

Coordinate your estate plan and avoid using direct beneficiary designations

If your will creates a trust for an individual’s inheritance, then you should not designate that individual as direct beneficiary to any plans or policies. Also, if you reside in a common-law province or territory, you should not own assets in joint tenancy with that individual.³

Instead, you will generally want your assets to flow into your estate so that the trust conditions contained in your will apply to the individual’s share of your estate. Assets flowing outside of the estate will not be subject to the terms and conditions of your will.

For that matter, if you are planning to leave a bequest to a trust for an individual while also leaving direct bequests to one or more other persons, then you should avoid directly designating any of these persons as direct beneficiary, or owning assets jointly with any of them. If you reside in a common-law province or territory, then using beneficiary designations or joint tenancy may permit you to reduce the probate fees that would apply on your death, but you might then inadvertently dilute the inheritance of the individual for whom you created a trust.

³ Joint tenancy is not applicable in Quebec. Beneficiary designations cannot be made in Quebec except with respect to life insurance policies and qualifying annuities. In the rest of Canada, beneficiary designations can typically be made with respect to life insurance policies, RRSPs, RRIFs, TFSA, pension plans, and locked-in accounts.

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Consider RDSPs

Registered Disability Savings Plans (RDSPs) are savings plans designed for the long-term financial security of persons with disabilities. Contributions up to certain annual limits may be eligible for federal grants, and RDSPs for beneficiaries with a low income may qualify for federal bonds.⁴ An RDSP may be established for a beneficiary who:

- Is eligible for the federal disability tax credit,
- Is a resident of Canada,
- Has a valid Social Insurance Number, and
- Is turning 59 or younger.

RDSP contributions can be made until the end of the year the beneficiary turns 59, but grants and bonds can only be received in years when the beneficiary turns 49 or younger.

RDSPs can receive up to \$200,000 in private contributions, up to \$70,000 in federal grants, and up to \$20,000 in federal bonds. Most provinces and territories fully or at least partially exempt the value of an RDSP from social assistance asset tests, and fully or partially exempt the value of RDSP withdrawals from income tests.

A large lump sum contribution to an RDSP may be disadvantageous, especially when it concerns the federal grants available. Typically, it is better to contribute to an RDSP gradually over time rather than all at once. Accordingly, if you are planning to leave an inheritance to a person with disabilities, the use of a discretionary trust is still likely appropriate. The trustee will be able to use the trust funds to make RDSP contributions on behalf of the person where the trustee considers it appropriate.

Other resources

If you would like more information related to these topics, ask your IG Advisor for a copy of one or more of the following:

- #1223, “Acting as a personal representative”,
- #1395, “Adding an adult child as joint owner (Non-Quebec residents)”,
- #1752, “Registered Disability Savings Plans (RDSPs)”,
- #2035, “Estate Planning Guide”,
- #2066, “Beneficiary designations - The do’s and don’ts”,
- #2217, “Leaving an inheritance to a financially irresponsible person: Why using a testamentary spendthrift trust may be right for you”, and/or
- #2255, “Leaving an inheritance to a minor or young adult – Why using a testamentary trust may be right for you”.

⁴ The Canada Disability Savings Grant (CDSG) and the Canada Disability Savings Bond (CDSB) are provided by the Government of Canada. Eligibility depends on family income levels. Speak to an IG Advisor about special RDSP rules; any redemption may require repayment of the CDSG and CDSB.



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