

10 ESTATE PLANNING FOR FAMILIES WHO HAVE CHILDREN WITH SPECIAL NEEDS IN B.C.

One of the greatest sources of anxiety for parents of children with Autism Spectrum Disorder, indeed for all parents of children with special needs, is fear of what the future may hold for their children. While some children with ASD do grow up to lead independent lives, others will be unable to maintain full-time employment as adults, and still others may not be able to enter the workplace at all. Parents have justifiable concerns regarding the financial well-being of their adult children with ASD.

This chapter discusses estate planning for families with special needs children. It has been written by Blair Dwyer, a well-known Canadian tax lawyer. Blair has been a Senior Rulings Officer with Revenue Canada and a partner in McCarthy & McCarthy (now McCarthy Tétrault) in Toronto and Vancouver. Blair Dwyer established his own firm, Dwyer Tax Lawyers, in 1995, specializing in tax and estate planning. He is the author of several publications on Canadian tax law and has taught Advanced Taxation at the University of Victoria. He is the father of two children with Autism Spectrum Disorder.

Estate planning is simply having a financial plan to guide you in making your financial decisions. It involves setting a goal and adopting strategies that will help to achieve that goal. The following commentary discusses various strategies that might be considered in the context of an estate plan. Whether any specific strategy is useful, however, depends on the goals that you and your family have set.

The chapter is divided into three parts. The first part deals with estate planning for the disabled child. The second part deals with the federal Registered Disability Savings Plan, a mechanism under which friends and family of the disabled child can set aside assets for the benefit of the disabled child. The third part deals with estate planning for the parents of the disabled child.

When dealing with estate planning, a writer always inserts disclaimers. So here they are:

- The comments in this chapter are based on the law in force in British Columbia. The law may differ in other provinces.
- The commentary in this chapter is based on the rules in force in February 2009. This chapter might not be updated on a regular basis, so double-check on monetary limits and other details.
- This chapter provides general commentary so that you are in better position to seek professional legal advice that is based on the specific circumstances of you and your child. This chapter is not a substitute for that professional legal advice.

PART 1: ESTATE PLANNING FOR THE CHILD

When your child is under the age of majority, you — as the legal guardian of your child — get to make various decisions on behalf of your child. However, this changes when your child becomes an adult.

The age at which a child passes into adulthood varies from province to province. In British Columbia, that age is 19. So you might want to consider having your child sign some legal documents as part of his or her 19th birthday “coming of age” celebration. These could include:

- A Last Will and Testament.
- A Power of Attorney or Financial Representation Agreement.
- A Health Care Representation Agreement.

Last Will and Testament

While your child might not have much in the way of assets at age 19, this may change in the future. If you establish a Registered Disability Savings Plan (RDSP) for your child, any funds remaining in that plan on the death of your child will be part of your child’s estate and will be governed by your child’s will. If your child does not have a will, any funds in the RDSP will be governed by intestacy laws.

Power of Attorney: Being Your Child's Agent in Respect of Financial Matters

You might have your 19-year-old child appoint you as his or her agent so that you can deal with financial matters on behalf of the child. There are two ways of doing this:

1. Have your child sign a "Power of Attorney."¹
2. Have your child enter into a "Representation Agreement" in respect of financial matters.

In both cases, the child would be appointing you as his or her agent. This means that you will be able to act as the child's representative in respect of financial matters.

I will use the term "Agency Document" to refer to both Powers of Attorney and Financial Matters Representation Agreements. Certain features are common to both types of documents, whereas other features differ between the two types of documents.

You should consult professional advice to determine whether your child should sign a Power of Attorney or a Financial Matters Representation Agreement. In general, the Power of Attorney is an older form of document and is more broadly recognized. In order to sign a Power of Attorney, however, a person has to have legal capacity (has to be capable of managing his or her own affairs). If you have some concerns as to whether your 19-year-old child has that ability, it might be better to have the child sign a Financial Matters Representation Agreement. In general, the Office of the Public Guardian (a provincial government office) has more supervisory powers under a Financial Matters Representation Agreement.

Whether the child signs a Power of Attorney or a Financial Matters Representation Agreement, it is important to remember that the Agency Document merely appoints you as the agent of your adult child. It does not displace the adult child's ability to deal with his or her own assets. An adult child who has signed an Agency Document generally also has the power to terminate the Agency Document. This is subject to a decline in the child's ability to manage his or her own affairs, in which case the child might lose that ability.

When acting as the agent of your adult child, you must act at all times in the best interests of your adult child.

¹ The term "power of attorney" is unfortunate. As your child's attorney, you are your child's agent. It does not mean that you are your child's lawyer!

If your child signs a Power of Attorney, consider whether your adult child should sign a simple Power of Attorney or an enduring Power of Attorney. A simple Power of Attorney ceases to be effective if your adult child becomes incapacitated (legally incapable of managing his or her own affairs). In order for your authority to survive the child's incapacity, the Power of Attorney must be an enduring Power of Attorney. In other words, it must specifically state that it survives incapacity and must be signed in the presence of a lawyer or notary public.

It may be best for your child to sign several originals of the Agency Document, as you will need to produce the original on various occasions. For example, you might want to lodge a copy with your child's financial institution.

An Agency Document can be general or specific. A general Agency Document will apply to all financial and other assets of your adult child. A limited Agency Document might apply only to a bank account or some other specific asset.

If the child's financial institution wants your child to sign that institution's own form of Agency Document, make sure that the document does not revoke any other more general Agency Document that your adult child has already signed.

For more information about both types of Agency Documents, refer to www.cba.org/BC/public_media/wills/180.aspx. For information about Financial Matters Representation Agreements in particular, refer to www.nidus.ca/?page_id=46.

Representation Agreement: Health and Personal Care Decisions

At age 19, your child will also have the right to make his or her own health and personal care decisions. For simplicity, I will refer to these as health care decisions.

As the parent of an unmarried adult, you will have the right to make health care decisions only if your unmarried adult child is unable to make the decision on his or her own (for example, the child is in a coma or does not have the mental capacity to make the decision). While this is the general legal rule, this rule can be displaced. If your adult child gets married, the child's spouse takes on this role. As well, your unmarried adult child can sign a Health Care Representation Agreement and appoint some other specific person to make health care decisions on behalf of the child.

Since it can be difficult to prove that your unmarried child has not appointed another person to make health care decisions, it might be prudent to have

your child formally appoint you as his or her health care representative by signing a Health Care Representation Agreement to that effect. This formally appoints you as the person who will make health care decisions for your adult child if the child is in a coma or is otherwise unable to make the decision. However, the document merely appoints you as the alternative decision maker; it does not remove your child's ability to decide on his or her own if the child is able to make that decision.

For more information about a Health Care Representation Agreement, refer to www.nidus.ca/?page_id=46.

While there are two types of documents under which your child can appoint you as an agent in respect of financial matters, only one type of document — the Health Care Representation Agreement — is valid in respect of health care decisions.

PART 2: REGISTERED DISABILITY SAVINGS PLANS

As noted, many parents fear for the future financial well-being of a disabled child. One way to address this concern is to establish a registered disability savings plan (RDSP) for the disabled child. Funds contributed to an RDSP can grow on a tax-deferred basis and provide future income for the disabled child. An RDSP can also qualify for government grants.

In order to have an RDSP, the disabled individual must reside in Canada and must qualify for the disability tax credit. In many cases, an individual with ASD will qualify for the disability tax credit. For more information on this tax credit, see www.cra-arc.gc.ca/tx/ndvdl/tpcs/ncm-tx/rtrn/cmpltng/ddctns/Ins300-350/316/menu-eng.html.

The great advantage of an RDSP is that income earned in the RDSP is tax-free until paid out from the RDSP. Accordingly, this allows income to be built up on a tax-deferred basis for the ultimate benefit of the disabled individual.

Unlike contributions to a registered retirement savings plan (RRSP), contributions to an RDSP are not tax deductible. The real benefit of the RDSP is that investment income earned in the RDSP will accrue tax-free inside the RDSP. In other words, a 5% return inside the plan is a 5% return, not a 2.5% return after taxes. This brings the power of compounding into play. As noted in the **box** on the next page, \$200,000 contributed in equal monthly amounts of \$308.61 and earning a constant 5% rate of interest will turn into \$980,090 after 54 years.

When income is paid out from the RDSP, the income will be taxed as income of the disabled individual. And when the disabled person receives capital (the amounts contributed to the RDSP), no income tax applies to the capital (because the capital was not deductible when it was contributed and has therefore already been taxed). Generally, each payment out of the plan will be a combination of tax-free contributions and taxable income (based on the value of contributions to total plan assets).

A disabled person can have only one RDSP at a time. However, it is possible to switch an RDSP from one financial institution to a new financial institution.

Anyone can contribute to an RDSP (as long as the person directing the plan accepts the contribution). Once an RDSP is established for the benefit of a specific disabled individual, friends and family—even the disabled individual—can contribute to that plan. However, all funds in the RDSP are

THE POWER OF COMPOUNDING

Assume that Mom and Dad open a registered disability savings plan for their autistic son as soon as the son is diagnosed at age 5. In total, \$200,000 is contributed to the RDSP over 54 years in monthly instalments of \$308.61. The RDSP consistently earns a net 5% return (after expenses). At the end of 54 years (as the child turns 60 and the RDSP must start paying out), the RDSP would have a value of \$980,090.

The time at which contributions are made has a significant effect on the final value of the plan. Other things being equal, it is best to contribute early. To illustrate this, modify the above example by assuming that the \$200,000 is contributed over 20 years at a rate of \$833.33 per month. After 20 years (assuming a constant net 5% return), the value of the plan would be \$338,169. Since the maximum private contribution level is \$200,000, no further private contributions can be made to the plan. Assuming that the plan continues to earn the constant net 5% return, however, the plan will have a value of \$1,776,519 when the child reaches age 60. The end value of the plan is higher by \$796,429 due solely to the earlier timing of the contributions.

The above examples are based only on private contributions to the RDSP. They do not include any return on the government contributions of up to \$90,000 (\$70,000 in matching contributions and \$20,000 in non-matching contributions). Those government contributions represent an immediate bonus but will also earn tax-deferred returns within the plan.

The purpose of the above examples is merely to illustrate the power of the tax-deferred compounding that can take place within the plan. The examples do not take inflation into account. Remember that the purchasing power of a dollar is likely to decline over time as prices increase due to inflation. At a constant 2% annual inflation rate, \$980,090 would be equal to \$336,400 in today's dollars and \$1,776,519 would be equal to \$906,075 in today's dollars. It is important to keep inflation in mind when estimating returns. Most financial projection software will allow you to make projections based on assumed rates of return and assumed rates of inflation.

Remember also that you need to deal with the net rate of return (after expenses of administering the plan).

for the benefit of the disabled individual. A contributor cannot get his or her contributions back.

All funds remaining in the RDSP on the death of the disabled individual belong to the estate of the disabled individual and pass under the disabled individual's will (or under intestacy rules, if the disabled individual dies without a valid will). When establishing an RDSP for a disabled individual, it would be prudent to have the individual sign a last will and testament as soon as the individual is able to do so (for example, on reaching the age of majority). This is particularly important if the disability might result in the individual losing the ability to make a will in future.²

Establishing the RDSP

While anyone can contribute to an RDSP once it is in place, only certain individuals can actually set up the RDSP. Those individuals are as follows:

1. The disabled person (assuming that he or she is an adult and is legally competent).
2. If the disabled person is a minor, a legal parent of the disabled person.
3. If the disabled person is not legally competent (for example, does not have sufficient mental capacity to direct his or her own affairs), a guardian, tutor or curator of the disabled person. The identity of these persons will depend on the law in force in the disabled person's province of residence. This could include a provincial agency that maintains the disabled person. While a parent can be a guardian of a mentally incompetent adult child, the parent has to be appointed as guardian under the relevant provincial law.

Thus, if a plan is set up while a child is a minor, the parents will likely be the ones to set up the plan.

The RDSP has to be opened with an approved issuer (one that has registered a model plan with the federal government). As of January 20, 2010, the BMO Bank of Montreal, RBC Royal Bank, Canadian Imperial Bank of Commerce (CIBC), Scotiabank, and TD Waterhouse are the only financial institutions to offer an RDSP in British Columbia. Les fonds d'investissement FMOQ inc. also offers an RDSP. For any recent additions to this list, refer to www.hrsdc.gc.ca/eng/disability_issues/disability_savings/financ_org.shtml.

² Marriage automatically revokes a will, so the disabled individual should make a new will if the disabled individual marries.

While the Income Tax Act sets out minimum requirements for an RDSP, some variations will be possible within those minimum requirements. Accordingly, different financial institutions will have different plans with different rules governing those plans.

For example, the tax rules require that the plan start to pay an annual amount to the beneficiary starting when the beneficiary reaches age 60. But what if the beneficiary requires emergency funds prior to age 60? The income tax rules do not prohibit early payments out of an RDSP,³ but the rules of the specific plan might or might not permit early payments. This will depend on the wording of the specific plan (not the Income Tax Act). Parents should check the wording of the plan on this point, as this may vary between financial institutions.

Be conscious of fees charged by the plan issuer and investment managers. These might be based on a percentage of the value of the plan assets (not a percentage of only the income earned). As well, consider the types of investments that can be made inside the plan. The purpose of the plan is to accumulate tax-deferred income for the future use of the disabled beneficiary, so you want the plan to have the potential to make a reasonable income and also keep pace with inflation.

Administering the RDSP

Once set up, the RDSP is overseen by a “director” (or manager).⁴ The RDSP director is responsible for making investment decisions and for deciding when to make distributions to the disabled person. Of course, the director can get appropriate advice from any source that the director chooses before making those decisions.

At first, the director will be the person who sets up the plan.⁵ For example, if a parent sets up a plan, the parent will be the initial director. The parent could include the disabled person as a co-director or could introduce the disabled person as a director at some later time. While the disabled person can act as a director, it is not necessary that the disabled person be a director.

Once the initial director is no longer able to act as a director, who can take over as a successor director? Only the beneficiary or a “qualified person” in

³ There may be tax implications of an early withdrawal, such as a duty to repay some government contributions to the plan. However, the question here is whether the plan allows an early withdrawal at all.

⁴ “Director” is the term used in the Income Tax Act. The term does not refer to a director of a corporation.

⁵ Person or persons, to be precise. A plan can be set up by two persons jointly (for example, both parents).

respect of the beneficiary can act as a successor director. A “qualified person” is defined as a person who could set up a RDSP for that beneficiary (if the RDSP were not already in existence).

If the parents establish the RDSP and take on the role of initial directors of the plan, the following are possible successor directors on the death of the last surviving parent:

1. If the beneficiary is not mentally competent, the beneficiary’s guardian.
2. If the beneficiary is mentally competent, the beneficiary.

There is no provision for appointment of relatives or spouse of a beneficiary (unless the relative or spouse is the guardian of a beneficiary who is not legally competent).

After the eventual death of the beneficiary, the executor of the beneficiary’s estate would act as RDSP director. At that point, the director would merely deal with the winding-up of the plan.

Non-Government (Private) Contributions

As noted, anyone can contribute to the RDSP once it has been established. Contributions can be made until the end of the year in which the beneficiary reaches age 59, but are limited to a lifetime maximum of \$200,000 per beneficiary.⁶

There is no annual limit on contributions—just the \$200,000 lifetime limit. However, annual limits apply in respect of federal government matching contributions. So even if you had \$200,000 available when you set up the plan, you might not want to plunk the \$200,000 into the plan all at once. There are two conflicting objectives here. By contributing money to a plan while a child is young, that money has more time to accumulate tax-deferred income for the eventual use of the child. In order to maximize matching contributions—which also grow the plan—it may be necessary to pay careful attention to when contributions are made.

Government Contributions: Two Types

An RDSP can receive two types of government contributions (but only in years while the beneficiary is under age 49). The first type (the Canada Disability Savings Grant) is a form of matching contribution that requires the making of private contributions in the year in question. The second type (the Canada Disability Savings Bond) does not require that a private contribution be made.

⁶ The \$200,000 limit does not include government grants and bonds paid into the RDSP.

Both forms of government grants depend on family income levels. Family income includes the income of the child's parents while the child is under age 19. Once a disabled child turns 19, however, the child's family income does not include the income of the child's parents.

Government Matching Contributions (Canada Disability Savings Grant)

The federal government will match some contributions to an RDSP. This matching program is referred to as the Canada Disability Savings Grant (CDSG).⁷ The lifetime limit on government matching contributions is \$70,000.

The applicable matching rates are as follows:

- If family income is over \$81,941 (amount for 2010 year), the government matches dollar-for-dollar on the first \$1,000 of private contributions. In other words, a \$1,000 private contribution becomes a \$2,000 total contribution.
- If family income is below \$81,942 (amount for 2010 year), the government will contribute \$3 for each dollar of contributions on the first \$500 of private contributions and \$2 on the next \$1,000 of private contributions. In other words, a \$1,500 private contribution becomes a \$5,000 total contribution.

For this purpose, “income” means income as calculated for purposes of claiming the federal child tax benefit. The relevant income is the income from the second preceding taxation year. For example, if a RDSP contribution is being made for the 2008 taxation year, look at family income for the 2006 taxation year.

A special rule applies for 2008 only. Because financial institutions did not have RDSPs available until December of 2008, RDSP contributions made prior to March 2, 2009 will qualify for CDSGs as if the contribution had been made in 2008.

If the beneficiary is 18 years of age or younger, family income includes the income of the child's parents. However, inclusion of parental income stops when the child reaches age 19. Once the beneficiary is 19 or older, family income is income of the beneficiary and the beneficiary's spouse. This is the case even if the adult child lives with his or her parents.

⁷ Think of this as a matching contribution rather than a grant. This government money is triggered only if someone other than the government contributes money to the RDSP.

You might want to pace contributions so as to take maximum advantage of the matching government grants. This would involve reserving at least \$30,000 of contribution room for years after the child has reached age 18 (assuming that the child will be below the \$81,942 (amount for 2010 year) income threshold for at least 20 years between age 18 and age 49).⁸

The director of the RDSP can refuse contributions in order to maximize access to the matching government contributions (by saving private contribution room for other years).

To be eligible for government matching, private contributions to an RDSP have to be made while the beneficiary is under age 49.

Non-Matching Government Money: The Canada Disability Savings Bond⁹

In addition to the matching contributions discussed above, the federal government will pay a \$1,000 Canada Disability Savings Bond (CDSB) annually to an RDSP if family income for that year is below \$23,856 (amount for 2010 year). This additional CDSB grant amount is reduced if family income exceeds \$23,855 (amount for 2010 year) and disappears completely once family income is \$40,970 (amount for 2010 year). The income thresholds are indexed for inflation.

For this purpose, family income is determined in the same way as for the government matching contributions (see [the discussion of the Canada Disability Savings Grant](#)). Once the beneficiary reaches age 19, parental income is not included in the beneficiary's family income.

The lifetime CDSB limit is \$20,000 per beneficiary. As well, the CDSB is paid only while the beneficiary is under age 49.

Payment of the CDSB depends strictly on family income level. It is not dependent on someone making a private contribution to the RDSP in that year.

⁸ As noted, the lifetime limit for matching government contributions is \$70,000. This is equal to 20 years worth of \$1,500 contributions when family income is below \$81,942 (amount for 2010 year).

⁹ The government terminology is really unfortunate. The Canada Disability Savings Bond is not a form of investment. It is a government grant that depends solely on income level (and does not require that someone make a private contribution to the RDSP in the year).

Repayment of Government Amounts

The CDSG matching contributions and the CDSB amounts are subject to repayment in certain cases:

- If the beneficiary dies or ceases to qualify for the disability tax credit, the CDSG and CDSB paid into the plan within the previous 10 years have to be returned to the federal government (together with the accumulated income on those amounts).
- Repayment of at least part of the CDSG or CDSB may be required if amounts are paid out of the plan within 10 years of the plan receiving a CDSG or CDSB.

Distributions from the Plan

The RDSP has to start making annual payments to the beneficiary no later than the end of the year in which the beneficiary reaches age 60. The RDSP director can decide to start making annual payments when the beneficiary is under age 60, but it is important to remember that the RDSP might have to repay some of the CDSG matching contributions and CDSB amounts that the RDSP received within the 10 years that precede any early payment.

Once annual payments start, they have to be made each year and are subject to annual maximum limits based on life expectancy of the beneficiary and the value of the assets in the RDSP.

Generally, life expectancy will be the general life expectancy for a person of the beneficiary's age and sex. This information will be posted on the Canada Revenue Agency website (www.cra-arc.gc.ca/menu-e.html). However, the annual maximum distribution limit can be based on the life expectancy of the specific beneficiary if a medical practitioner certifies that the specific beneficiary's life expectancy is shorter. For example, the beneficiary may have chronic health problems.

The maximum annual distribution limit is generally equal to

1. The value of the assets in the plan at the beginning of the year, divided by
2. Three plus the remaining number of years in the beneficiary's life expectancy.

Or, if the beneficiary has outlived his or her life expectancy, the maximum distribution is equal to one-third of the remaining value of the plan assets (a declining balance basis).

For example, assume that an RDSP has been established for Ben. Assume that Ben is 60 years old with a life expectancy of 70 and that the RDSP has \$100,000 in assets at the start of the year. Since Ben has 10 years left in his life expectancy, the \$100,000 is divided by 13 (10 plus 3) and the maximum annual distribution is \$7,692.30 for that year.

The maximum annual distribution will change each year. Assume that the value of the plan is still \$100,000 at the start of the next year (investment income was equal to the distribution). As Ben is now 61 and has a remaining life expectancy of 9 years, the \$100,000 is divided by 12 (9 plus 3) and the maximum annual distribution is \$8,333.33.

The maximum annual limit does not apply to emergency payouts of capital (assuming that these are permitted under the terms of the plan), as these would be extraordinary payments. However, any extraordinary capital payout will usually result in a requirement to repay at least some of the CDSG matching contributions and CDSB amounts received by the RDSP within the preceding 10 years.

Taxation of Distributions

Each distribution paid to a beneficiary is a mix of taxable and non-taxable amounts. This is best illustrated by an example.

Assume that Ben's RDSP has \$100,000 at the start of the year in which Ben receives a distribution. This \$100,000 consists of the following amounts:

- \$60,000 from private contributions.
- \$20,000 from government grants (CDSG and CDSB), but none in the past 10 years (no grants have been made since Ben turned 49).
- \$20,000 in accumulated investment income.

Each dollar of distribution during that year is considered to have been taken on a proportional basis from each of the above asset pools. Since \$60,000 out of the \$100,000 asset base comes from private contributions (that is, $60,000/100,000$ or $6/10$), 60 percent of each dollar distributed will consist of non-taxable capital. The rest will be income.

In the example, assume that Ben receives a \$10,000 distribution. The tax result is as follows:

- \$6,000 of the \$10,000 will be tax-free (i.e. $6/10$ of \$10,000, which equals \$6,000).
- This means that the other \$4,000 will be included as taxable income.

RDSP benefits are not included in income for calculating the Goods and Services Tax Credit and the Canada Child Tax Benefit.

Whether RDSP distributions affect the beneficiary's status under provincial benefit programs will depend on the province of residence. British Columbia has indicated that RDSP distributions will not be taken into account when determining whether a disabled individual is eligible for assistance under British Columbia benefit programs. For more information, see rdsp.com/blog/.

RDSPs and RESPs

There is currently no way to transfer funds on a tax-deferred basis from a registered education savings plan to a registered disability savings plan.

If a grandparent started a registered education savings plan for a grandchild and it subsequently turns out that the grandchild suffers from a disability that makes it very unlikely that the grandchild will ever attend university, the grandparent might be able to collapse the registered education savings plan and obtain a refund of the contributions made to the plan. The grandparent could then contribute that refund to a registered disability savings plan. However, income accumulated in the registered education savings plan will be lost.

Tax-Deferred Transfers from an RRSP to a RDSP

The 2010 federal budget proposes to allow tax-deferred transfer of a deceased individual's RRSP to the RDSP of a financially dependent infirm child or grandchild. To take advantage of this transfer, the RDSP beneficiary must have been financially dependent on the deceased individual by reason of physical or mental infirmity. An infirm child or grandchild is generally considered to be financially dependent if the income of the child or grandchild for the year preceding the year of death does not exceed a specified threshold (\$17,621 for 2010). If the infirm child or grandchild has income that exceeds this amount, it will be necessary to prove financial dependence.

The amount of RRSP proceeds transferred to the RDSP cannot exceed the available RDSP contribution room in respect of the infirm child or grandchild. Accordingly, no more than \$200,000 can be transferred from the RRSP to the RDSP (this amount is reduced by any previous contributions made to the RDSP by any private individual). The amount transferred from the RRSP will count against the \$200,000 lifetime RDSP contribution limit but will not qualify for matching government grants (the Canada Disability Savings Grants). Since the amount transferred from the RRSP will not have

been subject to income tax, that amount will be taxed as income when withdrawn from the RDSP.

In order to take advantage of this tax-deferred transfer, the RDSP beneficiary (or his or her legal representative) will have to file an election with the Canada Revenue Agency and with Human Resources and Skills Development Canada. The election would be filed at the time that the amount is transferred from the RRSP to the RDSP. Of course, the deceased must have (prior to the deceased's death) named the infirm child or grandchild as the beneficiary of the RRSP. This is a potential problem with the rules, as it assumes that the infirm child or grandchild will choose to transfer the RRSP death benefit to a RDSP (or has a representative who can make that choice for the infirm child or grandchild).

The above rules will be effective for deaths that occur on or after March 4, 2010.

For deaths that occur after 2007 and before 2011, special transitional rules will allow for similar treatment. In the case of deaths that occur after March 3, 2010 and before 2011, taxpayers may use either the general measures or the transitional rules. This is intended to accommodate situations where taxpayers may not have had an opportunity to adjust their estate planning to take advantage of the general measures (specifically, the RRSP does not designate the infirm child or grandchild as beneficiary of the RRSP). Persons who die after 2010, however, will be expected to have named their financially-dependent infirm child or grandchild as RRSP beneficiary.

The transitional rules will work in the following manner. If a person is an "eligible individual" in respect of the infirm child or grandchild, the "eligible individual" can choose to transfer the RRSP death benefit to the RDSP of the infirm child or grandchild of the deceased (the child or grandchild must have been financially dependent on the deceased). An "eligible individual" is a beneficiary of the deceased's estate or a person who received a portion of the death benefit paid out of the RRSP on the death of the deceased. While the RRSP amount will have to be included in income, an offsetting deduction will be provided (either on the deceased's final tax return or on that of the eligible individual who makes the contribution), provided the contribution is made before 2012. As with the general measures, an election would have to be filed with both the Canada Revenue Agency and Human Resources and Skills Development Canada.

To allow time for financial institutions and Human Resources and Skills Development Canada to adjust their RDSP systems, RDSP contributions benefiting from the 2010 budget proposals cannot be made before July 2011.

Carry Forward of RDSP Grants and Bonds

As noted, government matching contributions (the Canada Disability Savings Grants, or CDSG's) and government grants (the Canada Disability Savings Bonds, or CDSB's) are income-dependent. The 2010 federal budget proposes to allow a 10-year carry forward of CDSG and CDSB entitlements earned in or after 2008. When an RDSP is first opened, CDSB entitlements will be determined and paid into the plan based on the beneficiary's family income for the 10 preceding post-2008 years. Balances of unused CDSG entitlements will also be determined and maintained for the same period. CDSGs will be paid on unused entitlements, up to an annual maximum of \$10,500 (but this requires matching contributions).

The RDSP first became available in 2008. Accordingly, years prior to 2008 will not be taken into account in the 10-year carry-forward period. While this is a welcome proposal for those who are tardy in setting up an RDSP, it is far better to open the plan as soon as possible if the beneficiary qualifies for the CDSB (the CDSB does not require that any private individual contribute to the RDSP). While it is nice to get a CDSB in respect of past years, it is far more beneficial to claim the CDSB in the year in which the beneficiary first qualifies so that the CDSB can get into the RDSP and start to build tax-deferred investment income right away. The 10-year carry-forward does not replace the investment income that could have been earned if the CDSB had been paid into the plan in the earlier year.

The matching rate on unused CDSG entitlements will be the same as that which would have applied had the contribution been made in the year in which the entitlement was earned. Matching rates on RDSP contributions will be paid in descending order, with contributions using up any grant entitlements at the highest available matching rate first, followed by any grant entitlements at lower rates. Plan holders will receive annual statements of CDSG entitlements.

The carry forward will be available starting in 2011.

The following example is based on an illustration contained in the 2010 federal budget documents.

Roger is a low-income adult who has been eligible for the Disability Tax Credit his whole life. Roger does not open an RDSP until 2011, however.

In each of 2008 (the year RDSPs became available), 2009 and 2010, Roger will have accumulated \$500 in CDSG (matching) grant entitlements at a 300-per-cent matching rate, \$1,000 in CDSG (matching) grant entitlements at a 200-per-cent matching rate, and \$1,000 in CDSB (non-matching) entitlements. These entitlement levels are based on his family income, which is assumed to be below the relevant thresholds. As he did not have an RDSP in those years, however, none of the accumulated grants will have been paid.

Roger opens an RDSP in 2011. On creation of the RDSP, Roger's RDSP will automatically receive \$4,000 in CDSBs (non-matching grants). This consists of \$3,000 of CDSBs that had accumulated during the years 2008, 2009 and 2010 (at \$1,000 per year) plus the \$1,000 of CDSB payable in respect of 2011. Payment of the CDSB requires merely that the RDSP be open and that Roger's family income be below the relevant income threshold. Payment of the CDSB does not require that anybody actually contribute funds to the RDSP.

After the RDSP is opened and before the end of 2011, Roger's family contributes \$400 to his plan. The \$400 contribution generates \$1,200 in CDSG (matching) grants (equal to 300% of the \$400 contribution). This uses up \$400 of the \$500 in 300%-level grant room that arises in respect of 2011. The \$100 unused amount of (matching) grant room is added to the \$1,500 of unused 300% CDSG (matching) grant room carried forward from 2008, 2009 and 2010. As a result, Roger has the following carried-forward CDSG (matching) grant room as of the end of 2011: \$1,600 of carried-forward 300% room and \$4,000 of carried-forward room at the 200% level (\$1,000 of unused 200% room carried forward from each of 2008, 2009, 2010 and 2011).

When the carried-forward entitlements are added to his 2012 grant entitlements, Roger has \$2,100 in 300% grant room and \$5,000 in 200% grant room.

In 2012, Roger's family contributes \$3,000 to his RDSP. The first \$2,100 of the family's contribution uses up the \$2,100 in 300% CDSG (matching) grant entitlements and generates \$6,300 (300% of \$2,100) in matching contributions. The remaining \$900 of the family's contribution is matched at the 200% level and generates \$1,800 (200% of \$900) in additional CDSG (matching) contributions. In total, Roger's RDSP receives \$8,100 (\$6,300 and \$1,800) in CDSGs (matching contributions) in 2012. In addition, his RDSP receives a CDSB of \$1,000 based on his bond entitlements for 2012. As only \$900 of the family's contribution was applied against the carried-forward \$5,000 in 200% grant room, Roger carries forward \$4,100 in unused 200% grant room for use in future years when Roger, his family or his friends make additional contributions to the RDSP in those subsequent years.

The example is illustrated in the following table.

Year	Contributions	Accumulated Grant Entitlements			CDSG Paid	Accumulated Bond Entitlements	CDSB Paid
		300%	200%	100%			
2008		\$ 500	\$ 1,000	\$ 0		\$ 1,000	
2009		\$ 1,000	\$ 2,000	\$ 0		\$ 2,000	
2010		\$ 1,500	\$ 3,000	\$ 0		\$ 3,000	
2011	\$ 400	\$ 1,600	\$ 4,000	\$ 0	\$ 1,200		\$ 4,000
2012	\$ 3,000		\$ 4,100	\$ 0	\$ 8,100		\$ 1,000
TOTALS	\$ 3,400				\$ 9,300		\$ 5,000

As noted, it is good that grant room is not lost because one is unable to open an RDSP right away or because one is unable to contribute in some years. However, it is far better to open the RDSP as soon as possible if only to receive the non-matching CDSB grants if family income is below the relevant threshold. While grant room is not lost, the tax-deferred income that could have been accumulated in the earlier years is lost.

Provincial Payments into RESPs and RDSPs

To the extent that provincial and territorial governments make payments into RDSP's, these provincial and territorial payments will receive the same treatment as federal CDSG (matching) grants and CDSB (non-matching) grants. This means that the payments will not use up a beneficiary's \$200,000 private-contribution room and will not generate federal matching contributions.

PART 3: ESTATE PLANNING FOR THE PARENT

The parents of a disabled child will likely want to ensure that their own estate planning will address the special needs of their child. There are two aspects to this. The parents need to think about planning that will be effective during the lifetime of the parents (so as to deal effectively with unexpected bumps in the road). As well, the parents will be concerned about what happens after they have both passed away. Accordingly, estate planning for the parents' assets can be divided into the following two phases.

1. Planning that will operate during the parents' lifetimes. This is referred to as living or *inter vivos* planning and can include the following:
 - A Power of Attorney or Financial Representation Agreement.
 - A Health Care Representation Agreement.
 - The establishment of a living (inter vivos) trust.
2. Planning that will become effective only on the parent's death. This is referred to as testamentary planning and includes the following:
 - A last will and testament.
 - Beneficiary designations under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF) or life insurance policy.

Living (inter vivos) planning

Each parent should appoint at least one other person as that parent’s agent. If the parent is incapacitated as a result of an accident, the agent would be able to deal with the parent’s financial assets. There are two ways of doing this:

1. Sign a “Power of Attorney”.¹⁰
2. Enter into a “Representation Agreement” in respect of financial matters.

I will use the term “Agency Document” to refer to both Powers of Attorney and Financial Matters Representation Agreements. I will use “Financial Agent” to refer to the person who is appointed as agent under those documents. Certain features are common to both types of documents, whereas other features differ between the two types of documents.

Each parent should have at least one Financial Agent. For parents who are in a stable relationship, the natural choice will be each other. However, what if both parents are in a coma as a result of being in the same car accident? If you and your Financial Agent frequently spend time together or frequently travel together, you need to appoint an alternate Financial Agent who can act in case the primary Financial Agent cannot.

You need to be able to trust your Financial Agent implicitly. The Financial Agent will have the power to deal with all your assets at a time when you are incapacitated. As a result, the Financial Agent would be able to abuse that power. Imagine that you are paralyzed and that you are completely dependent on one other person for your survival. Who would you choose as that other person? Once you have the answer, you have the range of people who you would trust enough to act as your Financial Agent.

You should consult professional advice to determine whether you should sign a Power of Attorney or a Financial Matters Representation Agreement. In general, the Power of Attorney is an older form of document and is more broadly recognized. The Representation Agreement may be more appropriate if a parent does not have the mental capacity to sign a Power of Attorney.

If you decide to sign a Power of Attorney, you can choose to sign an enduring Power of Attorney. A simple Power of Attorney ceases to be effective if you become incapacitated (legally incapable of managing your affairs). In order for your Financial Agent’s authority to survive your incapacity, the Power of Attorney must be an enduring Power of Attorney. In other words, it must specifically state that it survives incapacity and it must be signed in the presence of a lawyer or notary public.

¹⁰ The term “power of attorney” is unfortunate. The attorney is your agent, not your lawyer. You can appoint anyone to act as your agent (you do not have to appoint a lawyer).

It may be best to sign several originals of the Agency Document, as your Financial Agent may need to produce the original on various occasions.

For more information about both types of Agency Documents, refer to www.cba.org/BC/public_media/wills/180.aspx. For information about Financial Matters Representation Agreements in particular, refer to www.nidus.ca/?page_id=46.

Representation Agreement: Health and Personal Care Decisions

If you are unable to make your own non-emergency health care decisions (for example, you are in a coma), physicians will look to the following individuals for decisions on your non-emergency health care:

- First, your spouse.
- Secondly, any one of your children. The health care provider can take instructions from any child who happens to be available. No statutory order of priority applies as between the children.
- Any of your parents.
- Any of your siblings.
- Anyone else related by birth or adoption. No order of priority applies to these other persons.

This is what the law provides if you have not appointed specific individuals to make those health care decisions for you. If you want some other order of priority, you can sign a Health Care Representation Agreement and appoint some other individual to make the health care decisions that you are unable to make. For example, it may be that one of your children would not be able to make a health care decision on your behalf and that you would prefer that the physicians consult only one specific child or a specific group of children.

The person you appoint needs to have a good sense of what your wish would be in the specific situation at hand. While you could prepare a set of written guidelines, it is more important that you personally discuss this difficult topic with your representative. If the representative has to make a difficult decision, it will be much easier if the representative has had the chance to discuss end-of-life matters with you.

If you decide to leave some written guidelines for the representative, remember to review and re-sign the guidelines annually (for example, each New Year's Day). There is nothing worse than being presented with guidelines that are 10 years old and have been signed only once. By signing the guidelines

annually, you are letting your representative know that you have reflected more than once on the guidelines and that your view has remained consistent down through the years.

Having said this, it is important to recognize that written guidelines are merely that—guidelines. They are not legally binding and are there only for the assistance of the representative. Your representative will make a decision based on what is in the guidelines, what you told the representative during that all-important conversation, and the representative's own judgment in the context of the circumstances at hand.

There is a proposal to introduce a legally binding health care directive in which you can give binding instructions about medical procedures which can and cannot be used. If the law changes to give such documents legally binding status, think carefully before signing such a document. Remember that medical technology changes over time—what is impossible today might be possible a few years from now. Think about whether it is better to appoint a carefully-chosen individual who can make a decision based on the circumstances at hand and that individual's knowledge of you, or whether it is better to have a written instruction that cannot be second-guessed in light of new medical technology.

For more information about a Health Care Representation Agreement, refer to www.nidus.ca/?page_id=46.

Registered Retirement Savings Plan/ Registered Retirement Income Fund

Many parents will have savings in a Registered Retirement Savings Plan (RRSP) or a Registered Retirement Income Fund (RRIF). These plans are set up to provide a source of retirement income and are therefore a form of inter vivos planning. However, you also need to make decisions about what to do with any assets left in the RRSP/RRIF on your death. This **testamentary form of planning** is discussed below.

Tax-Free Savings Account

Effective January 1, 2009, each Canadian who is 18 years of age or over will be able to contribute \$5,000 per year¹¹ to a tax-free savings account. Contributions are not tax-deductible, but interest income earned in the account is not taxable, even when the interest is withdrawn. Withdrawals can be made for any purpose, so you may wish to consider opening such an account and earning tax-free income in that account rather than in an ordinary taxable account.

¹¹ The \$5,000 annual limit will be adjusted each year for inflation.

Registered Disability Savings Plan

Parents and others may wish to contribute to a registered disability savings plan (RDSP) for the benefit of their child with ASD. This topic is discussed in [Part 2: Registered Disability Savings Plans](#).

Living (Inter Vivos) Trust

If the parents operate an incorporated private business, the parents may wish to reorganize the business so as to issue shares to a family **trust**. This will enable the corporation to pay dividends to the family trust, which can then use the dividend income for the benefit of an adult disabled child. The income can be distributed to the child as an allowance or can be used to cover expenses of the child (such as payment of rent). If properly structured, the income will be taxed at the child's tax rate (which will often be lower than the tax rate payable by the parent). If a parent is the director of the private corporation, that parent will control whether and to what extent the trust receives dividends.

The family trust will be a living (inter vivos) trust, a trust established during an individual's lifetime (as opposed to a testamentary trust that is established on the death of the individual). A testamentary trust pays income tax at **graduated rates**—the rate of tax increases as income increases. In contrast, a living trust pays the top rate of income tax on each dollar of income. However, the trust can deduct income that is paid to (or used for the benefit of) a beneficiary, in which case the beneficiary pays the tax on that income. For this reason, a living trust is usually used strictly as a flow-through vehicle. The family corporation will pay dividends to the family trust only if the trust will be immediately “flowing” that income out to a beneficiary.

WHAT ARE GRADUATED RATES?

If you pay tax at graduated rates, your tax rate increases as your income increases. For example, you might pay a 22% tax rate on your first \$36,000 of taxable income and a higher rate on your next \$36,000 of taxable income. In a graduated rate system, a husband and wife pay less aggregate tax if each earns \$30,000 than if only one of the spouses earns \$60,000.

If you pay tax at a flat rate, the tax rate is the same on each dollar of taxable income (no matter how much or how little income is earned).

Individuals and testamentary trusts pay tax at graduated rates. In contrast, corporations and living (inter vivos) trusts pay tax at flat rates.

Testamentary (as of the Date of Death) Planning

The most obvious example of testamentary planning is a last will and testament. A will deals with the disposition of the assets that are owned as of the date of death, and does not become effective until death. This means that you can change your will as often as you want. Other examples of testamentary planning are beneficiary designations in a life insurance policy, a registered retirement savings plan and a registered retirement income fund:

1. Your will deals with assets that you own on the date of your death (except for assets that you hold as a **joint tenant** with someone else). In your will, you get to specify how those assets are dealt with after your death. You can instruct that the assets be gifted to someone outright or held in **trust** for someone.

WHAT IS A TRUST?

A trust is an arrangement under which a person (called a “Trustee”) holds specific property (called “Trust Property”) for the benefit of another (called the “Beneficiary”). There can be any number of Trustees and any number of Beneficiaries. Usually, the Beneficiaries are described by some common attribute (for example, “the children and other descendants of John Smith”).

A trust has to be established by someone (a “Settlor” or “Trustmaker”) who gifts property to the trust. If the Trustmaker gifts the property during the Trustmaker’s lifetime, the trust is known as a living trust (also called an inter vivos trust). If the Trustmaker’s gift occurs only on the death of the Trustmaker (for example, the Trustmaker established the trust in the Trustmaker’s last will and testament), the trust is known as a testamentary trust.

The trust document (usually called a Deed of Trust) will set out the specific rules that govern the trust. There is a great deal of flexibility as to the terms of the trust. If the Deed of Trust is silent on a specific point, the matter will be governed by general legal rules found in the provincial Trustee Act. However, the Deed of Trust can make specific rules that apply only to that specific trust arrangement. For example, the trustee can be told to hold the property until the beneficiary reaches a specific age. Or the trustee can be told to hold the property until the trustee decides that the beneficiary is mature enough to receive the property.

Thought needs to be given to the exact scope of the trustee’s powers. Two competing objectives often come into play. On the one hand, the Trustmaker might want to be able to set out exactly what the trustees should and should not do. On the other hand, the Trustmaker might want to give the trustees the flexibility to respond to unexpected situations (especially if the trust might last a long time).

My preference is to give very broad discretionary powers to the trustee. This means selecting a wise trustee and relying on the good judgement of that trustee to use those powers only if and to the extent necessary. The mere fact that the trustee has a power to do something does not mean that the trustee is obligated to use that power. The power is like the sweater that you always take on vacation (even if you are travelling to Arizona): if the weather turns cool unexpectedly, it is nice to have the sweater along. Otherwise, the sweater stays in the suitcase.

2. Assets in an RRSP or RRIF can have significant value. These assets can pass under beneficiary designations filed directly with the financial institution that administers the plan. For income tax reasons, you would normally designate your surviving spouse as the beneficiary. However, you should also consider appointing an alternative beneficiary in case you and your spouse are killed in the same accident. In certain circumstances, you might also be able to transfer RRSP or RRIF assets on a tax-deferred basis to a dependent child.
3. The mortality benefit payable under a life insurance policy is an asset that comes into existence on death. You designate beneficiaries in a document filed with the life insurance company. In most cases, the mortality benefit will be exempt from income tax no matter who receives it.

THE TWO FORMS OF JOINT OWNERSHIP

There are two separate types of joint ownership: one is joint tenancy and the other is tenancy-in-common. They have very different estate planning consequences. If you own property jointly with another person, you need to know which type of joint ownership is involved. This means looking at the document that set up the joint ownership.

Joint Tenancy

If you hold property with another person as a joint tenant, you have no control over what happens to that asset on your death. If you die and another joint owner survives you, your ownership interest passes automatically to the surviving joint tenant. In other words, the last joint owner — the one who outlives the others — automatically becomes the sole owner of the asset. Your will has no relevance to the ultimate ownership of the asset, and your interest in the asset does not become part of your estate. Your portion of the asset automatically passes to the surviving joint tenant under a right of survivorship.

Spouses often hold assets as joint tenants so that the asset will pass automatically to the surviving spouse.

It is less common for a parent to hold an asset in joint tenancy with a child. This is sometimes done to avoid probate taxes in provinces such as British Columbia and Ontario. However, holding assets in joint tenancy with a child can lead to a host of problems that are far more significant than the payment of probate tax.

Tenancy-in-Common

If you hold property with another person as a tenant-in-common, your interest in the property is part of your estate on death. As such, it is governed by your will. You can select who gets your share of that asset on your death by putting appropriate language in your will.

Example: Assume that each of you and another person (call that other person X) are joint owners of a parcel of real estate. Each of you has a 50% interest. Assume that you die before X does.

If you and X are joint tenants, X becomes the sole owner of the property on your death. However, if you and X are tenants-in-common, your 50% interest passes under your will. X then becomes a co-owner with your heirs.

General Overview: Death and Taxes

Even in death, we have to deal with taxes—specifically, the following tax rules:

1. On death, you are deemed to dispose of all your assets for fair market value. If the asset has increased in value since the date on which you acquired the asset, your estate may be liable to pay tax on what is called a deemed capital gain. This tax applies whether or not your estate actually sells the asset.
 - (a) An exception applies for the following assets:
 - (i) Assets left to your surviving spouse. In this case, the capital gains tax is deferred until the date on which the spouse sells the asset or the date on which the spouse dies (assuming the spouse has not remarried and has not left assets to a new surviving spouse).
 - (ii) Assets left to a testamentary spousal trust. This is a trust under which the surviving spouse is the sole beneficiary during the spouse's remaining lifetime. The capital gains tax then applies on the death of the surviving spouse. Effective when the surviving spouse dies, the trust has to pay the capital gains tax based on the value of the assets on the death of the surviving spouse. After payment of that tax, the remaining assets can be held for the benefit of other persons (such as children).
 - (b) Capital gains tax is paid only if the value has increased. If the asset has not increased in value, there is no tax.
 - (c) No capital gain applies on a personal residence as long as the residence has been used only as a residence and has a total area of less than one-half hectare (about 1.2 acres). If the residence is on a larger lot, part of the deemed gain may be subject to capital gains tax.
 - (d) In order to determine the amount of tax, some assets may have to be valued.
 - (e) The capital gains tax rate is about half of the rate that applies to ordinary income.
2. If you hold assets in an RRSP or RRIF, tax may apply on those assets.
 - (a) Exceptions apply, as discussed below. One exception is if the RRSP or RRIF is transferred into the RRSP or RRIF of a surviving spouse.
 - (b) If RRSP assets are taxed, the entire value of the assets will be taxed as ordinary income.

General Overview: Testamentary Trusts

You may wish to consider establishing a testamentary trust as part of your testamentary planning. You can establish a testamentary trust in most types of testamentary documents: your will, an RRSP/RRIF beneficiary designation, or a life insurance beneficiary designation. You cannot establish a testamentary trust in respect of property that you hold as a **joint tenant**, because that property passes automatically to the surviving joint tenant.

If property is held in a **trust**, a person (the Trustee) controls and manages the property (the Trust Property) for the benefit of one or more persons (the Beneficiaries). This can have advantages if there is a concern that the Beneficiary might not be able to manage the property wisely. There may also be income tax advantages. A testamentary trust pays income tax at **graduated rates** (as if the trust were a separate individual). For example, a testamentary trust would pay a 22% income tax rate on its first \$36,000 of taxable income. If a surviving child were to earn that income and have it added to the child's own income, the child might be pushed into a higher tax rate bracket.

HOW LONG CAN A TRUST LAST?

You will sometimes hear that a trust can last no more than 21 years. This is a common misconception that arises because of an income tax rule. Under this income tax rule, a trust is deemed to dispose of its assets every 21 years for fair market value proceeds. If trust assets have increased in value since the trust last acquired the assets, the trust may have to pay capital gains tax on that increased value as a result of the deemed disposition. However, the trust can simply pay that tax and carry on. If the trust has no capital gains (perhaps the trust is not investing in stocks), the deemed disposition of assets will not result in any need to pay tax. This is merely a tax rule that has to be dealt with every 21 years. Provided that the trustee has a plan to deal with any tax that arises as a result of the deemed disposition, there is no reason to terminate the trust prior to a deemed disposition anniversary.

In most provinces, the law requires that a trust terminate by the 21st anniversary of the death of the last beneficiary who was alive at the time that the trust was created. This is completely different from the tax rule under which a trust is deemed to dispose of its assets every 21 years for capital gains tax purposes. Both rules use the number 21, but the similarity ends there. In determining the maximum length of time that the trust exists, identify all the beneficiaries who were living at the time that the trust was created. Wait until the death of the last of that group of beneficiaries. The trust must terminate within 21 years of that last death. Given that healthy adult individuals can live into their 80's and 90's, a trust could last well over a hundred years in some circumstances.

The above rule applies to both living and testamentary trusts. The only difference is the date on which the trust starts. A living trust is a trust that is established during somebody's lifetime, so the date to identify the group of beneficiaries is the date on which the first person contributes the first item of property to the trust. A testamentary trust is one that comes into existence on someone's death (for example, the trust is created by the last will and testament of the deceased person). In this case, you need to identify the group of beneficiaries living at the date of that person's death.

If a testamentary trust is established, the trustee can elect to have some income taxed as income of the trust and to have the rest of the income taxed as income of the child (regardless of the age of the child). In other words, the trustee can “mix and match” in order to achieve the best income tax result for the child. If the trust is properly structured for flexibility, that “mixing and matching” can change from year to year to consistently get the best overall tax result for the child.

For example, assume that the after-tax value of the estate is \$500,000 and that this amount is invested at a 5% rate of return (annual income of \$25,000).

- If the \$25,000 in income were all taxed at the top rate, the total tax payable would be about \$10,925 per year.
- Instead, assume that the \$25,000 is earned by a testamentary trust. The applicable tax would then be all at the lowest of the marginal rates (i.e. 22% for a British Columbia resident). As a result, the total tax on the \$25,000 of income would be about \$5,500 (a saving of \$5,425 per year). Over 20 years, this tax savings would be equal to \$108,500.

The above example assumes that the trust distributes all its after-tax income. If the after-tax income were reinvested by the trust so as to earn even more income inside the trust, the tax savings would be correspondingly larger.

The actual amount of the annual tax savings will depend on the rate of return for the investments and the rate that would have applied if the investments had been held directly by the child.

There is no need to hire a trust company or other professional to act as trustee. Any individual in whom you have confidence can act as a trustee. The trustee is your surrogate and is there to make the decisions that you would have made in the circumstances. As a result, the chief qualification of the trustee is sound judgment and an understanding of how you would handle different situations. The trustee can always hire professional assistance to deal with investments, the filing of tax returns, and other matters that require specific knowledge.

Given that the **trust may exist for a considerable period of time**, it is best to build as much flexibility as possible into the trust documents. Much can be left to the discretion of the trustee.

If a disabled child is eligible for provincial income assistance that depends on the child’s income level, having assets held in fully discretionary trust for the benefit of that child can keep the child’s income low and preserve access to the income-tested benefits. This form of fully discretionary trust is sometimes referred to as a “Henson Trust”.

If the parent's assets include shares of a private corporation, and if the private corporation will continue to produce income beyond the parent's death, the shares of the corporation could be structured so as to allow income to be paid to a testamentary trust for the disabled child (even during the lifetime of a surviving spouse).

Last Will and Testament

Your will governs the assets in your estate (not assets that are held as a joint tenant).

In many cases, one spouse leaves all assets to the surviving spouse. However, it might be worthwhile considering whether to leave assets to a testamentary spousal trust. Leaving assets to a testamentary spousal trust can have the following advantages:

1. As is the case when assets are left directly to a surviving spouse, capital gains tax on the assets is deferred until the death of the surviving spouse.
2. Assets in the trust do not belong to the surviving spouse. Accordingly, you can specify what happens to the assets on the death of the surviving spouse (the assets are not governed by the will of the surviving spouse). This can be important in the case of a blended family.
3. The spousal trust can guard against hiccoughs in the estate plan. For example, the surviving spouse might remarry. However, marriage invalidates an existing will. If the surviving spouse neglects to redo a will after the remarriage, the surviving spouse could die intestate (without a valid will). If the surviving spouse dies without a valid will, assets that were intended for the children might go to the new spouse.
4. Income earned by a testamentary spousal trust can be taxed as income of the spouse or as income of the trust. Since a testamentary trust is taxed as a separate individual, the trust pays tax at its own set of **graduated rates**. This can result in the payment of less tax than if the income were simply added to the income of the spouse.

In a testamentary spousal trust, all the trust income must be payable to the surviving spouse for the remainder of the spouse's lifetime. However, the trustee will be able to elect to have income taxed in the trust if that produces income tax savings. The trustee can have a discretionary power to use capital for the benefit of the surviving spouse or can be instructed to retain capital for the benefit of the children.

While the surviving spouse must be the sole beneficiary during the lifetime of the surviving spouse, other beneficiaries (e.g., children) can be named as

beneficiaries effective on the death of the surviving spouse. At this point, the trust could be collapsed or kept in existence for the benefit of the children.

Registered Retirement Savings Plan/ Registered Retirement Income Fund

Many parents will have savings in a registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF). These plans are set up to provide a source of retirement income and so are a form of *inter vivos* planning. However, you also need to make decisions about what to do with any assets left in the RRSP/RRIF on your death.

As a general rule, tax applies on assets left in an RRSP/RRIF on your death. Those assets are taxed as ordinary income of your estate and generally will be subject to the top rate of income tax. As a general rule, therefore, the after-tax value of assets left in an RRSP/RRIF will be reduced by about half.¹²

There is a very important technical tax rule that can cause problems for funds in an RRSP/RRIF. If tax is payable on the RRSP/RRIF funds as a result of your death, the income tax is payable by your estate. The tax is not deducted from the RRSP/RRIF. This does not matter if the RRSP/RRIF beneficiary is also the beneficiary of your estate residue (the part of the estate that is left after giving specific amounts to specific people). If this is not the case, however, problems can arise. Consider the following simplified example.

1. Widower W dies with \$100,000 in his RRSP and makes his son S the sole beneficiary of the RRSP.
2. Widower W's only other (non-RRSP) asset is worth \$100,000. W's will leaves the residue of his estate to his daughter D.
3. The tax result is as follows.
 - (a) S, as the sole beneficiary of the RRSP, receives \$100,000 without deduction of any income tax. This is because the RRSP is deemed income of W and the tax on the \$100,000 deemed income inclusion has to be paid by W's estate.
 - (b) As noted, the estate has to pay all the tax on the funds in the RRSP as well as the tax payable on any assets that are part of the estate. Assuming a 50% tax rate (for the sake of simple math) and assuming that there is no tax on the assets that are part of the estate, the daughter receives at most \$50,000. Of course, the estate would also be liable to pay other expenses in connection with the administration of the estate, such as funeral and other expenses. So D would likely be left with considerably less than \$50,000 whereas S would have \$100,000.

So be very careful if you are thinking of naming one person as the beneficiary of your RRSP and some other person as the beneficiary of your estate residue. You need to get advice if you are planning to do this.

¹² The top rate of income tax for a British Columbia resident in 2008 is just under 44%, so the after-tax value would actually be about 56% of the amount left in the RRSP/RRIF at death. But half is easier to remember.

The tax on the funds in the RRSP/RRIF will be deferred in the following situations:

1. If you leave your RRSP/RRIF assets to the RRSP/RRIF of your surviving spouse.
2. If you leave your RRSP/RRIF assets to a child or grandchild who is financially dependent on you.
3. Under proposed legislation, if you leave your RRSP/RRIF assets to a Lifetime Benefit Trust (LBT) under which the sole beneficiary is
 - (a) A mentally impaired spouse; or
 - (b) A mentally impaired child or grandchild who is financially dependent on you. Whether a child with ASD is mentally impaired will vary from child to child.

The rest of this commentary will concentrate on the deferral for children and grandchildren. For purposes of simplicity, I will use the term “child” to refer to a child or grandchild.

Remember, the purpose of the rules discussed under this heading is to defer the tax that would otherwise apply on the funds in the RRSP/RRIF on your death. If the deferral rules do not apply, your RRSP will be taxed. But you can still use the after-tax value of the RRSP to fund a testamentary trust established in your will (as discussed in the general discussion on wills).

Financial Dependence

The concept of “financial dependence” is a narrow one. If the income of the child for the preceding year exceeds a basic threshold, it is presumed that the child is not financially dependent on you. While this is a rebuttable presumption, it can be difficult to rebut in fact. As well, there is a danger in planning based on a question of fact that might or might not be true as of a future event—your death—that you do not have control over.

The basic threshold under which the child is presumed to be financially dependent is equal to the basic personal exemption (\$9,600 in 2008). If the child qualifies for the disability tax credit, the threshold is increased by the disability tax credit amount (\$7,020 in 2008, for a 2008 total of \$16,620 for a child who is eligible for the disability tax credit). That is not a high threshold. As it is dependent on the previous year’s income, the child’s income must be monitored. No tax deferral will be available if the child had an unexpectedly high income in the year preceding your death (perhaps that was the year that the child was able to hold a job longer than usual).

Financial dependence is a requirement of both of the RRSP/RRIF tax deferrals involving children. To underline this, the following text will refer to a “financially dependent” child (which includes a financially dependent grandchild).

Transfer to a Financially Dependent Child

In the second situation, you leave your RRSP/RRIF assets to the financially dependent child or a trust for the financially dependent child. Depending on whether the financially dependent child qualifies for the disability tax credit, the result is as follows.

1. If the financially dependent child does not qualify for the disability tax credit, the tax deferral is a limited one. The deferral expires when the child reaches age 18. The RRSP/RRIF payout must be used to acquire a fixed-term annuity. The annuity term has to be no greater than 18 minus the child’s age. In other words, the annuity cannot last beyond the financially dependent child’s 18th birthday.
2. If the financially dependent child qualifies for the disability tax credit, the deferral does not expire on the child’s 18th birthday. In this case, the assets are left to the financially dependent child and the child places the assets in the child’s own RRSP/RRIF.¹³ As a result, tax arises only when the child withdraws the funds from the child’s RRSP/RRIF. If the child wisely keeps the funds in the child’s RRSP/RRIF and makes judicious withdrawals, the deferral of the tax can be significant.

Of course, the above assumes that the disabled child will act wisely and judiciously in respect of the funds held in the child’s RRSP/RRIF. This is not always the case, especially if the disability involves some degree of mental impairment. For example, a holder of an RRSP/RRIF can withdraw all the funds from the RRSP/RRIF even if such a withdrawal is unwise (the withdrawal will certainly result in tax, besides depleting capital). Indeed, it can sometimes be difficult for an individual with a mental impairment to even establish a RRSP/RRIF.

Lifetime Benefit Trust

The Lifetime Benefit Trust (LBT) proposal is intended to address the problems that can arise if the financially dependent child suffers from a mental impairment. Under the LBT proposal, you can leave your RRSP/RRIF on a tax-deferred basis to a trust (not a RRSP or RRIF) established for a mentally infirm and financially dependent child.

¹³ If the child is a minor who qualifies for the disability tax credit, there is an option under which the child (or a trust for the child) can use the RRSP/RRIF payout to acquire a life or fixed-term annuity.

The advantage of the LBT is that the assets are placed in a trust (not an RRSP or a RRIF). This means that the financially dependent child does not have an absolute right to withdraw the funds on demand. Instead, the trustee is in charge of what amounts are paid to the child and when. The trustee can distribute amounts to the child or defer the distribution to a later time. This gives the trustee control over the use of the income generated by the assets. Of course, the trustees must always consider the needs of the beneficiary (including the beneficiary's comfort and care) and must act in the beneficiary's best interest.

Your will needs to provide for the establishment of the LBT. The mentally impaired and financially dependent child must be the sole beneficiary of the LBT during his or her remaining lifetime. The terms of the LBT would be set out in your will.

Under the tax rules, the LBT does not have a great deal of discretion as to how it uses the RRSP/RRIF payout. The entire RRSP/RRIF payout must be used to purchase a qualifying trust annuity (QTA). An annuity is a form of investment that pays an annual amount for the remaining lifetime of a specified person (in this case, the infirm dependent) or for a fixed term (in this case, the maximum fixed term would be equal to 90 minus the age of the child). There is some negotiation room as to the exact terms of the annuity acquired. However, the annual payments will usually depend on economic expectations and interest rates that are prevalent at the time that the annuity is purchased.

The LBT would acquire the annuity and would receive the annuity payments. The trustee would then decide whether and to what extent to pass the annuity payments through to the child. All amounts passed through to the child would be taxed as ordinary income of the child. On the death of the child, any remaining value of the annuity will be taxed as ordinary income of the child. The terms of the LBT could provide that the after-tax amount be paid to other persons after the death of the child.

Summary

As noted, no one estate plan will be suitable for every family. It all depends on the family's circumstances and goals. The purpose of this article was to provide some background information so that you are in a position to pursue your own family's goals with the help of a professional adviser.