THE HENSON TRUST
TO SUPPORT DISABILITY PLANNING IN THE FAMILY

Social assistance for individuals with disabilities in Ontario is reduced and sometimes eliminated entirely if they have a certain level of assets or monthly income. If their assets (other than exempt assets) exceed $40,000, social assistance will be denied. If gifts and other voluntary payments by family are over $10,000 for any continuous twelve month period, that excess amount is counted as income and will reduce social assistance dollar-for-dollar.

This article is primarily based on Ontario law as a good practical example so taxpayers residing in other provinces will have to check their own rules. Generally, they are usually not that different.

Financial support by family members is often the only help available to improve the quality of life of an individual with disabilities beyond social assistance. Under the Ontario Disability Support Program (ODSP) rules, voluntary payments mentioned above would include trust distribution, honorariums and windfalls but do not include casual gifts of insignificant value such as basic clothing, meals and basic food purchases.

The Henson Trust is Born

Some years ago, Leonard Henson, wanted to provide a fund to assist his daughter, Audrey, so he set up a trust for her in his will. The terms of the trust gave the trustees complete discretion on the amount and timing of any payments to Audrey. Audrey could not demand payments from the trust because she was a discretionary beneficiary. That seemed to assure Leonard that his daughter would not be disqualified from ODSP because trust assets would not belong to her and trustees could control the income flow to meet her needs.

It worked and all provinces now allow Henson trusts..

In legal parlance, Henson trusts are referred to as *absolute discretionary* trusts. In other words, the trustees have absolute discretion for the management of trust funds and decisions to make payments to beneficiaries. On the death of the individual with disabilities, the assets remaining in the trust are usually disbursed to family members or sometimes to a charity.

Henson Trust Distributions

It has been suggested that payments made by a Henson trust to third parties on behalf of an individual with disabilities do not count as income that reduces ODSP support. That is clearly incorrect. Section 37(1) of the ODSP regulations indicates that income is calculated by adding the total amount of all payments of any nature paid to or on behalf of or for the benefit of the special needs individual. However, trust payments made for (ODSP approved) disability related items or services are exempt income that would otherwise reduce ODSP support.

Trusts and Taxation

Family members may wish to establish a Henson trust during their lifetimes or in their will. This is known as an inter vivos trust as distinguished from the testamentary trust. The purpose of the inter vivos trust is essentially the same as the testamentary trust which is to supplement the income of a person with disabilities and stay on side of the asset and income tests.

The inter vivos trust has a tax disadvantage since trust income is taxed at the top personal rate whereas testamentary trust income is taxed at graduated rates if they are Qualified Disability trusts. Trust income distributions may be helpful if they reduce trust income and are added to the taxable income of the recipient at lower tax rates.

Income taxes on a high tax rate trust can be reduced by what is called a preferred beneficiary election which allows trust income to be taxed in the hands of a beneficiary with disabilities. Since the beneficiary will most certainly be in a lower tax bracket than the trust, this is clearly a tax advantage. The beneficiary must be legally competent to make the preferred beneficiary election which is an added constraint.

CRA is raising the bar with respect to tax compliance for trusts. They expect that trustees comply with the terms of the trust and back up their actions with proper documentation. Some trustees are lax in documenting their actions to show they have complied with the terms of the trust and the tax rules governing their particular trust. In many cases, using a corporate trustee would be worth considering.

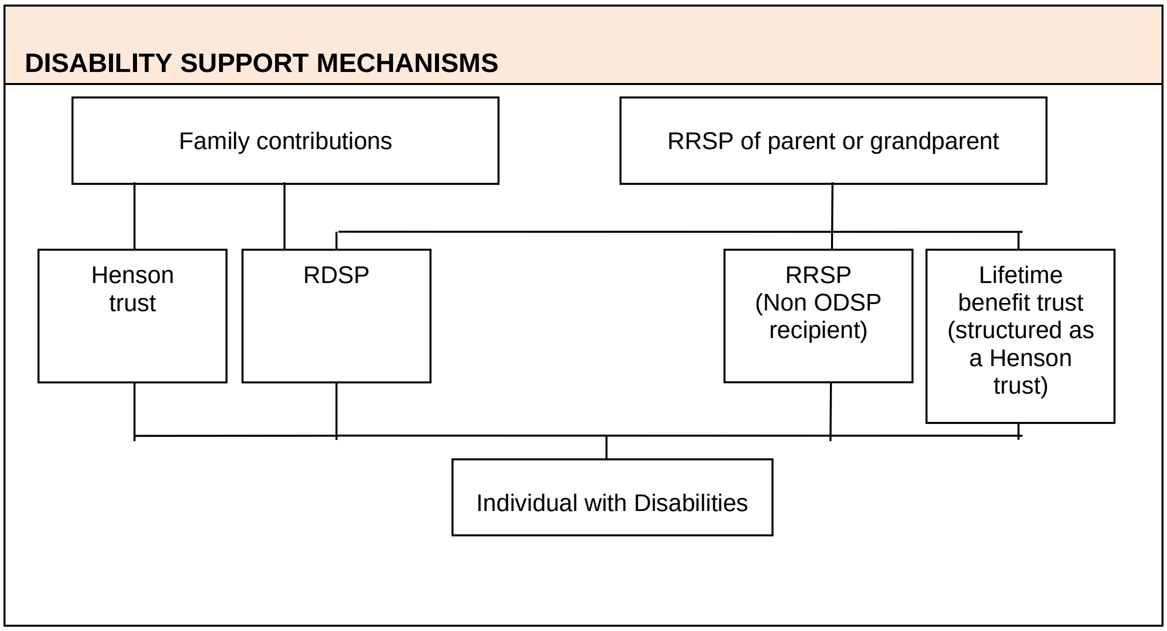
Trusts – Complying with Provincial Laws

The Accumulations Act in Ontario is another hurdle to overcome. This legislation dictates that after 21 years, income cannot be added to the capital of a trust and must be paid out. Normally this is not a problem because the trust will usually provide that annual income can be divided amongst all trust beneficiaries or distributed as the trustees determine. Since the ODSP benefit recipient cannot have any enforceable right to income or capital of the trust, the Henson trust must direct that part or all of the income after the accumulation deadline can be paid to another beneficiary or group of beneficiaries.

Investment powers of a trust are an important consideration. Legislation of some provinces mandates specific types of investments if none are specified by the trust. It is important, therefore, that the trust document specify the types of assets allowed as investments. In Ontario, the general rule is that investments must be made prudently.

Other Support Mechanisms

Until fairly recently, the Henson trust stood almost alone as the major funding vehicle to supplement income of individuals with disabilities. However, support can now be provided by other tax effective funding ways as illustrated below:



Space does not permit a discussion of these alternatives but they all can each apply separately or together depending upon the situation. That's where the family needs to put their heads together and do some serious financial planning for their loved one with disabilities.

Funding the Trust

Trusts can be settled with a variety of types of property including cash, investments, or real property of the person wishing to establish the trust. It is also possible to establish a trust using proceeds of a life insurance policy. If the trust is intended to be testamentary to obtain certain tax advantages, it is critical that the trust not be set up before death or own the insurance policy with the expectation that the proceeds will be paid into the trust.

An insurance-funded testamentary Henson trust can be structured in a will or separate declaration. If it is included in a will, care needs to be taken to try to ensure that estate administration tax (probate fees) is not triggered. The payment of insurance proceeds to or on behalf of a designated beneficiary is generally considered not to trigger this tax.

Choosing a Trustee for the Henson Trust

The trustees of a Henson trust (or any trust for that matter) have heavy responsibilities to beneficiaries with disabilities which should not be taken lightly. Some of the important ones are as follows:

- Involvement with the life of the individual with disabilities on an ongoing basis.
- A sensitivity to the financial requirements of the individual with disabilities.

- A good understanding of the terms of the trust and expectations of the settlor.
- A good understanding of provincial social assistance laws.
- Competent legal and financial advisors.

Trusts for Persons with Disabilities

◆ RDSP	Flexible asset accumulation and pension plan
◆ Principal Residence Trust	To hold a home with capital gains exempt
◆ Inheritance Trust	To hold inherited assets so they will be exempt assets under some provincial social assistance rules
◆ Lifetime Benefit Trust	To receive RRSP/RRIF proceeds from a supporting individual as a tax-free rollover for the benefit of an impaired child or grandchild
◆ Life Insurance Trust	To hold an insurance policy or more often to receive the proceeds of insurance on death
◆ Qualified Disability Trust (QDT)	A testamentary trust for a family member with a disability with graduated tax notes

The use of trusts in financial planning for an individual with a disability is complex and far reaching but particularly important in planning for intellectual disability. Families will need assistance from an experienced professional with an understanding of disability and the use of trusts if they are considering using any of them.

Talk to Uncle Bill

Henson trusts are designed to keep legal ownership of assets out of the hands of individuals with disabilities and restrict their income so they can get social assistance. But make sure you talk to Uncle Bill. You see, Uncle Bill is going to leave something in his will to his niece. If mom and dad have set up a Henson trust to maximize ODSP and uncle Bill gives that person a bequest, he may undo everything. Ask Uncle Bill to make his bequest to a Henson trust established in his will rather than giving direct bequest so social assistance is not lost.

Henson Trusts, Competence and Vulnerability

Henson trusts fill a special niche with respect to maximizing ODSP benefits but trusts in general are excellent vehicles for those who cannot or should not own property or may not be able to have a will. The trust becomes a holding tank to distribute funds to individuals with disabilities – even if the individual with disabilities does not receive social assistance. .

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