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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Estate planning for beneficiaries with disabilities

Planning considerations and options for
beneficiaries with disabilities

Regardless of your circumstances, it's essential to have an estate plan that reflects your personal and financial situation, and safeguarding the interests of a spouse, children and other family members is generally a priority. In situations where there's a beneficiary with a disability, there are often other considerations that must also be taken into account.

A major concern when planning for the benefit of a beneficiary with a disability is the financial well-being of the individual. Knowing your beneficiary's sources of income and whether they're receiving provincial disability benefits, as well as the beneficiary's capacity to make decisions about their property will heavily influence how you should structure your estate plan. This article highlights different estate planning strategies for beneficiaries with disabilities.

Although a comprehensive plan for a disabled beneficiary may involve plans relating to their ongoing care and living arrangements, this article will focus on estate planning strategies intended to provide financial support for a disabled beneficiary.



Considerations when estate planning for a beneficiary with a disability

When creating an estate plan that provides for a beneficiary with a disability, there are several considerations, including:

Ensuring the financial security of your disabled beneficiary

Determine the expenses of the intended beneficiary and if they have sufficient resources available to them throughout their lifetime to meet their financial needs.

Protecting government disability related benefits

You may want to consider how a gift or inheritance may impact your disabled beneficiary's eligibility for provincial disability benefits and how your estate plan can be structured to protect these benefits. Provincial disability support programs generally set limits on the assets a person can own and the annual income they can receive while in receipt of disability benefits. If these income and asset thresholds are exceeded, the person may be disqualified or ineligible to receive these disability benefits until the excess assets are depleted.

Not only may that person lose their entitlement to income support, but they may also lose other health and drug benefits that are only available to them only if they qualify for these provincial disability support programs. For example, in Ontario, individuals who are eligible for the Ontario Disability Support Program (ODSP) may be eligible for a range of other benefits and supports aside from income support. These include health benefits covering prescription drugs and dental care and assistance with expenses relating to the individual's disability, for example, hearing aids or guide dogs. The benefits of some of these services can be significant and the impact of potentially losing entitlement to such assistance should be taken into consideration when evaluating the merits of different estate planning strategies.

If your family has sufficient assets to support your disabled beneficiary for the rest of their life, and cover the ongoing costs related to their disability, then protecting their provincial disability related benefits may not be as great a concern. Your beneficiary may want to live off these assets and discontinue provincial disability benefits. Protecting provincial disability benefits may also not be a priority if your disabled beneficiary is nearing age 65 or is age 65 or older. This is because provincial disability benefits are generally only paid until the recipient reaches the age of 65, at which time the recipient may be eligible for senior benefits, such as Old Age Security (OAS) and the Guaranteed Income Supplement. As a result of receiving these benefits, they may no longer qualify for disability benefits.

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Your beneficiary's capacity to manage their assets

When estate planning for a beneficiary with a disability, there's often the question of capacity, specifically the beneficiary's capacity to manage property. In general, a person is capable of managing their property if they have the ability to understand the information that is relevant to making a decision about the management of their property, and appreciates what the outcome of a decision or lack of decision will be.

A person who is mentally incapable of managing property may not be able to receive or hold assets that are gifted to them outright. If they do not have a valid power of attorney for property (protection mandate in Quebec) in place that can manage these assets on their behalf, a guardian of property (which may be an individual or trust company) may need to be appointed by the court.

The use of a trust in such a circumstance may be an effective option to consider. The trustee can manage the assets on behalf of your disabled beneficiary. This may reduce or eliminate the need for a guardianship appointment.

Minimize taxes

You may want to ensure that your assets are transferred to your disabled beneficiary in a tax-efficient manner. This may help you leave more to your beneficiary.

Common estate planning strategies for beneficiaries with disabilities

Outright gift by Will or beneficiary designation

You may want to make an outright gift to your disabled beneficiary through your Will or by beneficiary designation on your registered plan or life insurance policy. This may be appropriate if your beneficiary has a physical, rather than mental disability, and does not rely on income and asset-tested provincial disability benefits. Your beneficiary can receive this gift and use it as they wish.

If your disabled beneficiary is a recipient of provincial disability benefits, you would need to consider how an outright gift may affect their access to their provincial disability support program. You may want to review the rules relating to the particular government program in

question of which your beneficiary is a recipient with a qualified legal advisor to determine how an outright gift may impact them.

You also should consider what will happen with an outright gift if your beneficiary lacks mental capacity. If your beneficiary is not mentally capable of receiving and managing property, and doesn't have a valid power of attorney for property in place, this gift may need to be paid into court or to a court appointed guardian of property.

Holding assets in trust

A common tool used in estate planning for a disabled beneficiary is a trust. The terms of a trust are usually set out in writing in a trust document. You can specify how you would like the property to be managed and when and how you would like the property to be distributed. A trust can be set up during your lifetime (known as an inter vivos trust) or on death, through your Will (known as a testamentary trust). It can even be funded with proceeds of life insurance or registered plan proceeds.

A trust may be particularly useful where a beneficiary is not capable of managing their own financial affairs as the management of the assets is determined by the trust deed and facilitated by the trustee(s). A trust may also help protect a disabled beneficiary's entitlement to provincial disability benefits. Each provincial disability support program has its own rules and policies relating to the amount of assets that can be held in a trust or amount that can be distributed from a trust without impacting a person's entitlement to disability benefits.

One type of trust that is often used to preserve a beneficiary's entitlement to government disability benefits is an absolutely discretionary trust, known as a "Henson Trust." A Henson Trust is an inter vivos or testamentary trust that provides the trustees with the absolute discretion to distribute income and capital from the trust to the beneficiary as they see fit. A beneficiary of a Henson Trust has no vested interest in the income or capital of the trust. This means they can't claim or demand payments from the trust and are not considered to own the trust assets. Consequently, most provinces have held that a Henson Trust is not an asset for purpose of their disability support programs.

There is no limit on the amount of assets that can be placed in a Henson Trust. There may, however, be limits on the distributions that can be made from a Henson Trust to the disabled beneficiary without diminishing their government benefits. The usefulness of a Henson Trust may therefore be limited by provincial regulations which restrict the distributions that a beneficiary can receive from a Henson Trust without impacting the beneficiary's

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income support and benefits. This should be considered when contemplating this estate planning option.

For more information on Henson Trusts, ask your RBC advisor for a copy of an article on this topic.

Taxation of trusts with a disabled beneficiary

Generally, income earned and retained in a properly structured inter vivos or testamentary trust is taxed at the highest marginal tax rate in the trust's province of residence. If income can be and is paid or made payable to a beneficiary pursuant to the trust agreement, it may be taxed in their hands at their marginal tax rate (subject to the attribution rules).

There are exceptions to this tax treatment where a trust is set up for a disabled beneficiary and certain other conditions are met. Some of these exceptions are discussed below.

Qualified Disability Trust (QDT)

If a trust qualifies as a QDT, the income earned and retained in the trust may be taxed at graduated tax rates. A QDT is a testamentary trust that jointly elects, together with one or more beneficiaries under the trust who qualify for the federal disability tax credit (DTC)¹, in its tax return for the year to be a QDT. To be a QDT for the year, several other conditions need to be met. For more information on these conditions, please ask your RBC advisor for our article on Henson Trusts.

A QDT may allow income to be split between the trust and the beneficiary(ies). Since income retained in the trust will be taxed in a manner similar to individuals, the incentive to allocate income to the disabled beneficiary to reduce taxes payable on trust income is reduced. This is helpful and provides flexibility to the trustee of the trust for the disabled beneficiary, as it's not always appropriate to make trust income paid or payable to a disabled beneficiary.

¹ The DTC is a federal non-refundable tax credit that helps persons with disabilities or their supporting persons reduce the amount of income tax they may have to pay. It's available for those who have a severe and prolonged physical or mental impairment, subject to approval by the Canada Revenue Agency.

It's also important to note that a beneficiary who qualifies for the DTC can only elect with one trust each tax year to be a QDT. This may be an issue where multiple persons have set up a trust in their Will for the benefit of the same beneficiary with a disability. The beneficiary will only be able to make an election for one of these trusts to be a QDT. This is something that should be taken into account when doing any planning for a disabled beneficiary.

Preferred Beneficiary Election

A trust and a “preferred beneficiary” (or the individual or organization legally authorized to make decisions on the preferred beneficiary’s behalf) can file a joint election to have some or all of the income earned and retained in the trust taxed in the beneficiary’s tax return at the beneficiary’s marginal tax rate. In such a case, the income continues to accumulate in the trust but is taxed as if it has been distributed to the beneficiary. This is beneficial and may provide tax savings if the beneficiary is in a lower tax bracket than the trust (as the income earned and retained in the trust may otherwise have been taxed at the top marginal tax rate).

To qualify as a preferred beneficiary, certain conditions must be met. They include:

- The beneficiary must be a resident of Canada;
- The beneficiary must be entitled to claim the DTC by reason of a mental or physical disability or must be an adult who was dependent on another individual because of a mental or physical disability and whose income does not exceed the basic personal exemption for that year (determined before allocations under the preferred beneficiary election), and
- The beneficiary must be the person who established the trust (the “settlor”) or the settlor’s current or former spouse or common-law partner, child, stepchild, grandchild, step-grandchild, great grandchild or step-great grandchild.

Note that the preferred beneficiary election and the election to be a QDT are not mutually exclusive. The preferred beneficiary election may be made where a testamentary trust qualifies as a QDT. In such a case, the income can be split between the QDT and the disabled beneficiary in such a way as to double the amount of income that can be taxed at low federal and provincial tax rates.

It's important to consider how the preferred beneficiary election may impact the beneficiary's eligibility for provincial disability benefits. For example, the beneficiary will be required to pay tax on the income allocated to them and may need additional funds from the trust to pay these taxes. This may result in the beneficiary's disqualification to provincial disability benefits.

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Choosing a trustee(s)

It's important to carefully consider who will act as the trustee(s) for any trust set up for your disabled beneficiary. Your chosen trustee will be faced with many responsibilities, including managing the trust assets, maintaining proper records and filing trust tax returns. You will want to consider your proposed trustee's age, as you will want them to outlive your beneficiary. As well, any proposed trustee must be willing and able to act and must understand that this obligation to administer the trust may continue for many years.

Your chosen trustee may have control and complete discretion to pay assets out to your disabled beneficiary under the terms of the trust. You will want to ensure that the trustee understands the unique needs and circumstances of your disabled beneficiary. You may also want them to be familiar with relevant provincial disability legislation and regulations.

In choosing a trustee, you may want to consider what the impact might be on the relationship between your trustee and beneficiary. You may consider whether there would be any conflict of interest. Such a conflict could arise, for example, where a sibling of the disabled beneficiary is named as the trustee of the trust and is also the ultimate beneficiary of the trust assets on the disabled beneficiary's death. If your trustee is given broad discretionary powers, they may refrain from making distributions from the trust to your disabled beneficiary, as these distributions may reduce their ultimate inheritance.

The role of a trustee is an extremely important one, involving several key legal obligations and fiduciary duties, as well as significant managerial and administrative responsibilities. Trustees are faced with many complexities and obligations and may feel burdened by the tasks of administering a trust, or may simply lack the time or expertise to undertake the role.

A trust company, like RBC Royal Trust, can help by acting as the trustee, co-trustee, or as an agent for the named trustee, to manage the trust assets. Some of the

advantages of a corporate trustee include neutrality, availability, expertise, and continuity for long-standing trusts. Appointing a corporate trustee can help ensure the administration of the trust is done in accordance with the relevant laws, relieve your family member or friends of the burden of administering the trust assets and mitigate any potential conflict among the trustees or with beneficiaries. A corporate trustee could be appointed while the settlor is alive or can be appointed to act as an agent for the named trustee after the settlor's passing according to a fee schedule, similar to compensation that may be payable to family members, friends, or other trusted professionals acting as trustee.

If you have questions about who to appoint as a trustee or the typical responsibilities of a trustee, please speak to your RBC advisor to find out more about the services provided by RBC Royal Trust.

Registered disability savings plan (RDSP)

An RDSP is a registered savings plan designed to assist individuals with disabilities in saving for their long-term financial needs. It offers tax deferred investment growth, generous government matching grants and bonds, and an opportunity for family members to assist with contributions.

An RDSP can be opened for the benefit of an individual who:

- Qualifies for the DTC
- Has a valid social insurance number
- Is a Canadian resident on plan opening, and
- Is under the age of 60

Depending on the age and mental capacity of the beneficiary, the RDSP beneficiary, parent or a person legally authorized to act on behalf of the beneficiary (and certain others in specific circumstances) may be the holder of an RDSP (i.e. the person who can open and manage the RDSP for the benefit of the beneficiary).

RDSPs don't have an annual contribution limit but there is a lifetime contribution limit of \$200,000. Contributions to an RDSP can be made until the end of the year the beneficiary turns 59. The income earned in the plan is not taxable until it's withdrawn from the RDSP. To accelerate the growth of an RDSP, the federal government offers matching grants (Canadian Disability Savings Grant (CDSG)) of up to 300% on RDSP contributions depending on the amount contributed and the beneficiary's family income. Contributions to an RDSP up until the end of the year a beneficiary turns 49 may attract CDSG of up to \$3,500 annually, with a lifetime limit of \$70,000. The federal government also deposits up to \$1,000 per year

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(known as the Canada Disability Savings Bond (CDSB)) into the RDSPs of low income beneficiaries until the end of the year the beneficiary turns age 49, with a lifetime limit of \$20,000. No contributions have to be made to an RDSP to be entitled to the CDSB.

Withdrawals from an RDSP can generally be made at any time but may be subject to restrictions and may trigger the repayment of government grant and bond if made prior to the beneficiary reaching the age of 60. Any income earned in the plan as well as grant/bond paid into the plan will be taxable to the beneficiary in the year withdrawn. Initial contributions to the plan are not taxable on withdrawal.

All provincial disability support programs fully or partially exempt RDSP as assets and income. RDSP withdrawals also generally don't affect eligibility for federal government income-based benefits such as OAS, the GST/HST credit and the Canada child benefit (CCB).

Depending on your disabled beneficiary's circumstance and your goals, an RDSP may be a useful estate planning tool. You can direct in your Will that funds be contributed to an RDSP for your disabled beneficiary. If you're a parent or grandparent of a disabled beneficiary who is financially dependent on you at the time of your death, there may be an opportunity to defer tax on your registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) proceeds on death if they are transferred to an RDSP for the benefit of your disabled beneficiary.

For more information on RDSPs, ask your RBC advisor for a copy of the article on this topic.

RRSP/RRIF assets

As a general rule, when you pass away, the fair market value of your RRSP/RRIF on death is included as income on your final tax return. Any income earned in your RRSP/RRIF after your date of death will generally be taxed in the hands of the beneficiaries you have named on your plan (or your estate if you haven't named any beneficiaries on your plan) in the year it is paid.

There may be an opportunity, however, to defer the tax on your RRSP/RRIF proceeds where you name a financially dependent child or grandchild, who is dependent on you because of a physical or mental disability as the beneficiary of your RRSP/RRIF. If they transfer the RRSP/RRIF proceeds to their own RRSP/RRIF or use the proceeds to purchase an annuity, any tax on your RRSP/RRIF proceeds can be deferred until they make a withdrawal from their own RRSP/RRIF or receive a payment from the annuity.

It's important to note that if your child or grandchild is dependent on you because of a mental disability, it may only be possible to implement this type of planning if the child or grandchild has a power of attorney for property (protection mandate in Quebec) or court appointed guardian of property.

As well, before designating your disabled child or grandchild as a beneficiary of your RRSP/RRIF, consider the negative effects it may have on their eligibility to receive provincial disability related benefits. If your beneficiary receives the RRSP/RRIF proceeds outright, or transfers them to their own RRSP/RRIF or annuity, this may jeopardize their entitlement to provincial disability benefits. An RRSP/RRIF is generally not an exempt asset for purposes of provincial disability related support programs.

If your child or grandchild who is financially dependent on you because of a mental or physical disability is a beneficiary of, or is eligible to open an RDSP upon your death, they can rollover up to \$200,000 of the RRSP/RRIF proceeds they receive (depending on previous contributions made to their RDSP) to their RDSP on a tax-deferred basis. This option may preserve your child or grandchild's entitlement to government income support as all provinces fully or partially exempt RDSP as an asset and RDSP withdrawals as income.

If your RRSP/RRIF assets are significant, and if your child or grandchild is financially dependent on you because of a mental disability (not physical disability), it may be possible to defer the tax on your RRSP/RRIF proceeds by having them pass to a lifetime benefit trust (LBT) set up under your Will for their benefit. An LBT is a personal trust under which a mentally infirm spouse of the deceased or a child or grandchild of the deceased who was financially dependent on the deceased because of a mental disability is the only person entitled to receive or use any of the income or capital of the trust during their lifetime. The trustees of an LBT must have the discretion to distribute amounts to the beneficiary and are required to consider the needs of the beneficiary in determining whether to pay amounts to the beneficiary.

In order to defer the tax on the RRSP/RRIF proceeds, the LBT must purchase a "qualifying trust annuity" (QTA) with the RRSP/RRIF proceeds and must be named as the annuitant of the QTA. The QTA must be for the life of the beneficiary or for a fixed term equal to 90 years minus the age of the beneficiary. The annuity payments will be paid into the trust, and are taxable to the beneficiary, even if these payments are not distributed from the trust to the beneficiary.

You may want to discuss whether a standard Henson Trust would qualify as an LBT with your qualified legal advisor.

Conclusion

There are many different considerations when planning for a beneficiary with a disability. It's essential to understand your beneficiary's needs, mental capacity and, if applicable, entitlement to government assistance. From there, you can look to the tools and structures that may be most suitable in the circumstances with the help of qualified legal and tax advisors. This will ensure there are no unintended consequences when providing for your beneficiary with a disability.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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