



Financial Advisory Solutions Team

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Henson Trusts

Planning for disabled dependants

Kathleen Strachan, LL.B. Financial Advisory Solutions Team (FAST)

In drafting his last Will and testament, Leonard Henson established a trust to allow his disabled daughter, Audrey, to benefit from his estate while preserving her entitlement to government assistance. The Will transferred his estate to three trustees and gave them the discretion to withhold or to spend the income and capital in whatever way would serve his daughter's best interests. The trustees could use the money from the trust to buy her a television set, or new clothes, or pay for a chaperoned trip to visit a relative, all without disqualifying her from government support. What the Will didn't do is give Audrey a legal claim to demand money. This meant the government could not treat the money as hers. Leonard Henson's planning worked. The government attempted to withdraw Audrey's social assistance after Leonard died, but the Ontario Court of Appeal ruled that Audrey was eligible and ordered that the payments be reinstated.

Unfortunately, this case was not a real victory for Audrey – the court case took years and she died before the Court of Appeal could rule in her favour. However, it was a significant victory for disabled beneficiaries across Canada. The trust that Leonard Henson set up for his daughter has come to be known as a "Henson trust."

The Henson trust

Most provincial regulations provide that individuals receiving disability payments are allowed to receive discretionary benefits from third parties without affecting their eligibility for disability payments.

The discretion afforded to the trustees of a Henson trust is the essential characteristic of the trust. For the trust to be effective, the trustees must have **absolute discretion** to distribute income and capital from the trust as they see fit. Conversely, they must also have absolute discretion to withhold the income and capital. The beneficiary of a Henson trust gains no vested right to the income or capital under the trust. They cannot claim payments from the trust, they cannot demand them, and they do not, as a result, own the contents of the trust.

As long as there is absolute discretion on the part of the trustees, a Henson trust can be set up on a testamentary (established by a deceased person) or inter vivos (established by a living person) basis.

Tax Treatment of a Henson trust

Trusts are separate taxpayers that must file their own income tax returns. Any income retained in a trust will generally be taxed in the hands of the trust, and any income paid out of a trust to a beneficiary is generally taxed in the hands of the beneficiary. Income retained in an inter vivos trust is taxed at the highest marginal tax rate and income retained in a testamentary trust is taxed at graduated rates.

When dealing with a trust for the disabled, there is an exception to the rule that income earned in a trust is taxed within the trust – the preferred beneficiary election.

THE PREFERRED BENEFICIARY ELECTION

The preferred beneficiary election is available when the beneficiary of a trust is suffering from a mental or physical impairment within the meaning of the Income Tax Act. The impairment has to be severe and prolonged. Additionally, the beneficiary has to be related to the person establishing the trust (the settlor). The beneficiary can be a spouse or common-law partner of the settlor (a former spouse or common-law partner qualifies as well), or can be a child, stepchild, grandchild, step grandchild, great grandchild or step great grandchild of the settlor.

Where a person qualifies as a preferred beneficiary, the trust and the preferred beneficiary, or their legal decision maker can file a joint election. That election has the effect of taxing income amounts on the beneficiary's tax return even though those amounts were retained in the trust – the income stays in the trust but is taxed as if it had been paid out to the beneficiary.

The planning opportunities that may exist around the preferred beneficiary election are:

1. A client has a modest amount of money and wants to settle a trust for a disabled beneficiary to improve the lifestyle of that beneficiary while sustaining their provincial entitlement for government support.

The preferred beneficiary election, where available, will provide for the income to be taxed at the disabled beneficiary's marginal tax rate, notwithstanding the fact that the trust might be an inter vivos trust. **The disadvantage is provincial regulations can change at any time and as a result, the individual may be cut off from disability support until they have used up all of the proceeds of the trust.**

2. A client wants to improve the lifestyle of a disabled beneficiary in the short term, and has a long-term goal of removing that beneficiary from government support.

The client can settle a large amount of money into a Henson trust. If the preferred beneficiary election is available, the income earned within the trust may be taxed at the disabled beneficiary's marginal tax rate. When the trustees conclude that the standard of living of the beneficiary may be significantly improved by sole reliance on funds within the trust, the trustees can begin to payout the income at a level that will disqualify the beneficiary from ongoing social assistance. **The disadvantage is there are some government programs available to individuals who qualify for government support that are not available otherwise. These programs cannot be replaced and most often cannot be purchased.**

Advantages of a Henson trust

A Henson trust provides the following advantages:

- Money from a Henson trust can substantially improve the quality of life of a disabled person – it can be used to pay for their expenses, such as trips, clothes, and homecare attendants while at the same time allowing their government support and access to government programming to continue.
- A Henson trust ensures that the disabled person is provided for financially, even in the event of the subsequent incapacity of the settlor (usually a parent) who established the trust.
- A Henson trust eliminates the payment of probate fees payable on the property settled in the trust insofar as those assets are to be transferred to residual beneficiaries, outside of the settlor's estate.
- A Henson trust can result in an overall savings of income tax: any income earned in the trust could be taxed at the marginal tax rate of the disabled person rather than at the highest marginal rate (inter vivos trusts).

Disadvantages of a Henson trust

A Henson trust provides the following disadvantages:

- Finding a trustee willing to care for a disabled person during their lifetime is difficult. Careful consideration must be given to the choice of trustees, as they will have complete control and absolute discretion over the trust's assets. Siblings, which are usually the most logical choice, often have a potential conflict of interest because they are likely to be the residual beneficiaries of the trust (during the lifetime or upon the death of their disabled brother or sister). **Appointing a corporate trustee such as a trust company may make sense especially where there are no close relatives able or willing to act or where the trust is likely to be administered over a lengthy period of time.**
- Provincial governments can change their regulations to disallow Henson trusts and apply those changes to existing and future trusts.
- An improperly constructed trust may disqualify a disabled person from their entitlement to disability benefits.

Availability of Henson trusts across Canada

A Henson trust is a matter of provincial regulation and is not uniformly present across the country. The following chart details the availability of Henson trusts in the various provinces and territories. Please note that the term "*Existent*" refers to the fact that Henson trusts are allowed within that province. The term "*Challenged*," means that one may establish a Henson trust however they have been challenged in the courts or are likely to be challenged in the future.

PROVINCE	STATUS OF HENSON TRUSTS	DECISION MAKING STATUTES FOR DISABLED PERSONS
Alberta	<p>Non Existent</p> <p>Changes to the Assured Income for the Severely Handicapped Act, R.S.A. 2000, c. A-45 on October 1st 1999, eliminated the possibility of Henson Trusts.</p> <p>Alberta lawyers are currently utilizing creative techniques to try to achieve the benefits previously provided by Henson trusts.</p> <p>Examples are:</p> <p>a) Establishing discretionary trusts and foregoing the disability benefits.</p> <p>b) Leaving the money with a guardian of the disabled person and trust they will honour their moral obligations, and that the Government of Alberta does not make a dependants relief</p>	The Dependents Adults Act.

	<p>claim against the estate on behalf of the disabled person.</p> <p>c) Creating four trusts – one holds \$95,000 for the disabled person. The second holds a car and a home. The third holds \$95,000 used to pay car, home expenses and trustee fees. The fourth holds the residue of the estate and names non-beneficiaries. The first trust is replenished by the fourth trust to work within the limits of the Dependents Relief Act.</p>	
British Columbia	Existent	The Patients Property Act.
Manitoba	<p>Existent (restrictive)</p> <p>The viability of Henson Trusts was tested and proven in the case of <i>Quinn vs. Director of Income Security</i>. However, regulation changes in April 2003 heralded more restrictive government treatment of Henson Trusts.</p>	The Vulnerable Persons Living with a Mental Disability Act.
New Brunswick	Existent	The Infirm Persons Act.
Newfoundland and Labrador	<p>Challenged</p> <p>Any trust settled with more than \$100,000 makes the beneficiary ineligible for government support.</p>	The Advanced Health Care Directives Act and The Mentally Disable Persons' Estates Act.
Northwest Territories and Nunavut	<p>Challenged</p> <p>Current laws may not permit Henson Trusts, but there has been no test case as of yet.</p>	The Guardianship and Trustee Act.
Nova Scotia	Existent	The Incompetent Persons Act.
Ontario	Existent	The Substitute Decisions Act.
Prince Edward Island	Existent	The Adult Protection Act.
Saskatchewan	<p>Existent</p> <p>An attack by the provincial government may be possible in some cases using the dependents relief legislation, but this is still untested in the</p>	The Adult Guardianship and Co-decision making Act.

	courts.	
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In the case of Quebec, where civil law based on the Code Napoléon is the system in force, a Henson trust can be established in a Will, however the Will usually contains an escape clause like: *should the trust be found to be incapable of accomplishing its purpose, then the assets will go to a third party*. That third party would have the moral obligation to use the assets in the interests of the person with the disability.

If you have any questions or require clarification on any of the issues discussed in this document, do not hesitate to discuss these with your advisor.

Note: The above information is based on the tax law in effect as of the date of this article. The article is for informational purposes only and should not be construed as offering tax or legal advice. Individuals should consult with a qualified tax and legal advisor before taking any action based upon the information contained in this article.

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