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Planning tools for special situations

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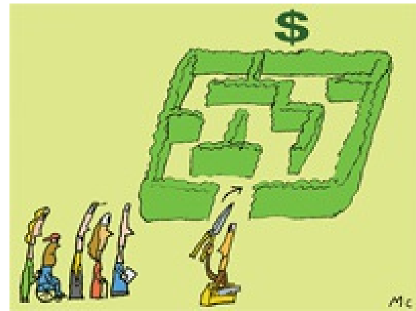
Illustration: Mike Constable

Special needs present challenges to advisers and also an opportunity to offer value and comfort to their clients



Clients voluntarily provide detailed and private information about their financial lives but they are less forthcoming with information about their personal lives. It is common to inquire about marital, financial and business matters but issues surrounding mental illness and physical disability are often not discussed. With approximately one in seven Canadians having a mental or physical infirmity, almost all clients will have a close family member with special needs. Identifying these situations is critical to providing proper advice to your clients. In this two-part article we will assist you in understanding some of the more pressing issues and planning ideas that you should be aware of.

According to a 2006 Statistics Canada survey, 43% of Canadians aged 65 and older have some form of disability, while only 4% of Canadians under the age of 15 have a disability. The statistics confirm that special needs are more likely to directly relate to a client, his or her spouse or parents rather than a child. No matter who has the special needs, the reality is that the whole family is affected.

Initiating the conversation
When prompted, clients are anxious to discuss their special needs issues, as they are concerned about what the future might hold for their loved ones. There is often a time lag between identifying the needs and issues and a client actually implementing a plan. This means the earlier you can engage your client the better. Identifying special needs situations and developing a financial response can relieve a huge amount of your client’s anxiety by giving him or her the peace of mind that comes from sound planning.

Discussions should neither start nor end with income tax issues. It is critical to understand how a person’s special needs affect the family. What is causing the disability or infirmity? Is the disability likely to progress? How are the special needs managed now and what will be required in the future? Who are the family caregivers now and is this sustainable or fair? Is mental capacity an issue? Is it likely to become an issue in the future? What are the caregiving, assistive devices and medical needs? These are just some questions to ask to help you understand your client’s reality.

Situations involving mental infirmity are often the most difficult to address. It may be your client who is developing the mental infirmity. Issues of mental capacity and competence require special expertise and can be quite emotional. Deciding who can make decisions for the family member (now, and in the future) as well as how to protect the person from financial abuse add to the complexities. Where mental capacity is likely to deteriorate, planning may need to be expedited.

There are various planning tools that should be considered in special-needs situations including government support programs, the use of trusts, income tax provisions and insurance. Carefully drafted wills, powers of attorney and guardianship directives are also critical.

Provincial support
The Ontario Disability Support Program (ODSP) is used here as a proxy for a provincial support program. ODSP is a "means-based" program for people who have a disability or infirmity and are over 18. ODSP eligibility generally ends at 65, when Old Age Security, the Guaranteed Income Supplement and other programs begin. Individuals aged 65-plus who are not eligible for OAS continue to qualify for ODSP support.

While the income support provided by the ODSP and most provincial programs is minimal, the coverage of drugs, dental costs, assistive devices, medical supplies, transportation and work-related expenses can be significant. Losing this coverage can be an inadvertent but costly result of poor planning. Only a small percentage of clients may have enough wealth that they are not concerned with how their planning affects provincial support programs.

As a general rule individuals are only eligible for ODSP if they meet the disability and age requirements and do not own assets (other than certain essential ones such as a principal residence, a vehicle, in some cases a second residence or vehicle, tools of a trade, student loans and prepaid funerals) exceeding $5,000 of value ($7,500 if the person is married and $500 for each child).

The monthly support is reduced by income earned from various sources. In addition, where cumulative gifts and inheritances received in the prior 12 months exceed $6,000, the excess is treated as income.

If an individual violates any of these asset and income tests, his or her access to government support can be diminished or eliminated. A well-intended gift from a friend or relative, even by way of a will, could eliminate ODSP eligibility.

Trusts and inheritances
There are tools that allow a client to provide financial support for a family member with a disability that preserve entitlement to provincial support. A Henson trust is an intervivos or testamentary trust that provides the trustees with absolute discretion as to when, if and how much of the capital or income will be paid to the beneficiary. Because the beneficiary does not have an absolute right to income or capital of the trust, it is not considered an asset by the ODSP. This is not the case in all provinces. The assets and income in a Henson trust are not excluded from the financial tests in Alberta and may not be excluded in Newfoundland and Labrador, Nunavut and the Northwest Territories.

Henson trusts are not without risks. The very reason they are excluded from most provincial support programs "means" tests is the fact that the beneficiary has no entitlement to the assets or income unless the trustees exercise their discretion in favour of the special needs beneficiary. Setting funds aside in a Henson trust may not provide a client with enough assurance that the beneficiary will be provided for. Where siblings are trustees, there is potential for conflict of interest. These sensitive realities must always be considered. Some people ponder leaving funds to children who are not receiving ODSP with the understanding that the funds will be used for the special-needs sibling. Using this technique puts the funds at more risk than a Henson trust and may run afoul of provincial legislation that requires parents to provide for financially dependent children of any age.

As other family members can be beneficiaries of a Henson trust, it is possible to combine this tool with other estate- and tax-planning techniques.

Inherited money may be exempt from the ODSP gift and asset tests if it is used to buy an approved disability-related item, a house (if the special-needs recipient lives in it), a car (if the special-needs recipient uses it as a primary vehicle) or to invest in a registered education savings plan or a registered disability savings plan.

Leaving a modest inheritance in a testamentary trust instead of as a direct bequest can preserve access to government funding. If inherited money is received directly by the special-needs recipient and placed in a trust (even if it is not a Henson trust) within six months, up to $100,000 of the trust may be exempt as an asset for ODSP purposes. However, the initial inheritance is treated as a gift in the month received, subject to the $6,000 exemption. The inheritance, in this form, will likely disqualify the recipient from ODSP entitlement for 12 months. However, if the funds are inherited directly through a testamentary trust, rather than personally with a transfer to a trust, ODSP entitlement can be maintained. The amount contributed to a testamentary inheritance trust will not be considered income and up to $100,000 of the value in the trust may be exempt as an asset even if the trust is not a Henson trust. The $100,000 limit is a continuing test and includes appreciation in the value of investments as well as income accumulated in the trust.

RDSPs and the income, grants and bonds received therein are generally excluded from a recipient's assets and income for ODSP purposes. Most provinces and territories have the same exemption but this fact should be confirmed in all cases.

What tax planning tools should you be aware of when advising in special-needs situations? The details are difficult but important to digest. In part II we will address specific tax rules and planning ideas you should be aware of in special-needs engagements.

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