

## Estate Planning with a Henson Trust

Coordinating with disability support payments



### Introduction

One of the primary concerns for families with a disabled individual is to provide whatever financial support they can without having an adverse impact on government benefits the individual is receiving. There are a few tools that can be used to accomplish this goal, one of which is known as a Henson Trust. This type of trust can be set up as a testamentary trust (established under the Will of a deceased person) or an *inter vivos* trust (established by a living person). Therefore, it can be set up for the individual when the person who settled the trust passes away, or is still alive.

The trust gets its name from a 1987 Ontario court case where the will of Leonard Henson was challenged by the Ministry of Community and Social Services. In that case, Mr. Henson created a trust for his disabled daughter Audra. He gave the trustees absolute discretion to withhold or spend both the trust capital and income on Audra's behalf. Audra did not receive any legal claim to the funds. The intention behind structuring the trust this way was to deter a claw back of Audra's Ontario Disability Support Program benefits.

The Ministry argued that the trust assets were Audra's, but Ontario Court of Appeal did not concur with the Ministry's argument. Unfortunately, by the time the Appeal Court rendered judgment, Audra had passed away. However the case had a ripple effect across the country, which beneficially affected other parents and children like the Hensons.

## The Henson Trust across Canada

Most provinces have passed legislation allowing individuals receiving disability support payments to also receive discretionary payments from third parties — without affecting their entitlement to provincial disability support. In mid-2018, Alberta joined the rest of the common law provinces, passing legislation to enable the Henson Trust strategy. In 2014 the Quebec Superior Court confirmed this strategy as legitimate.

In January 2019, the Supreme Court of Canada (SCC) considered Henson Trusts for the first time. It provided some clarity around the terms of a Henson Trust, but it did not provide certainty that a Henson Trust is safe from being considered an asset by government programs with means based eligibility tests.

The SCC case involved a Vancouver woman referred to as “A”, who applied to live in public housing. Prospective tenants were entitled to receive a low-rent subsidy. The housing authority discovered A was the beneficiary of a trust, and therefore deemed her ineligible for the subsidy. A argued the trust was a Henson Trust and therefore the assets of the trust should not be seen as belonging to her. The SCC ultimately agreed with A and upheld the terms of the trust as a Henson Trust and ruled therefore that the assets were not A’s assets.

Given the absolute discretionary nature of the trust, the SCC ruled that A did not have a vested interest in the trust, but only the “mere possibility” that she might benefit from it.

Further, the SCC ruled a Henson Trust must contain the following terms:

1. The trustees must have complete and unfettered discretion in determining whether to make trust distributions to the beneficiary;
2. The beneficiary must not have any legal right to compel a distribution of the trust funds;
3. The beneficiary cannot unilaterally collapse the trust.

Meanwhile, however, the SCC ruled that its decision should not be interpreted to mean that a Henson trust can never be treated as an asset. That determination will vary from program to program, and will depend on the eligibility criteria for the program.

While there are generally no limits to the amount of assets that can be placed in a Henson Trust, provincial regulation may restrict the amount of trust distributions that will affect support benefits. There can also be variations based on respective provincial regulation regarding how the discretionary funds can be spent. Some examples of typically accepted expenditures include homecare, medical equipment, clothes and chaperoned travel.

With these caveats in mind, it is recommended that a lawyer who regularly drafts Henson Trusts in the province where the intended beneficiary resides be consulted. Counsel should be able to provide a full picture of the impact of a Henson Trust on the individual’s continued benefit entitlement.

## Tax Treatment of a Henson Trust

Trusts are separate taxpayers from the named beneficiaries. A separate income tax return must be filed for a trust. Income retained in a trust is taxed in the hands of the trust and generally, at the top marginal tax rate. Income that is distributed to a beneficiary is taxed in the hands of the beneficiary.

There are some exceptions for the taxation of trusts at the top marginal rate and two such exceptions are established specifically for disabled individuals. The first is known as a *Qualified Disability Trust (QDT)*. This is a testamentary trust that annually elects with the beneficiary for the trust to be deemed a QDT. The income held within the QDT can then be earned, retained and taxed based on the same graduated tax rates that apply to individual taxpayers.

To qualify as a QDT the following conditions must be met:

1. The electing beneficiary must be eligible for the federal Disability Tax Credit (DTC). Note that not every person who receives provincial disability benefits will necessarily qualify for the DTC;
2. The electing beneficiary must have been specifically named as the beneficiary in the document, e.g., the Will or trust document, which established the trust.
3. The election must include the electing beneficiary’s social insurance number;
4. The electing beneficiary must not make a QDT election with respect to any other trust;

5. The trust is not subject to the federal recovery tax for the year;
6. The trust must be resident in Canada throughout the year.

The second exception regarding taxation of a Henson Trust is the use of a *preferred beneficiary election*. This election must be filed jointly by the trust and preferred beneficiary to have some or all income that is earned and retained in the trust taxed in the beneficiary's hands. This strategy assumes the beneficiary's tax rate is lower than the trust's. How this strategy may affect disability support payments should be considered.

To qualify as a preferred beneficiary the following conditions must be met:

1. The beneficiary must be resident in Canada;
2. The beneficiary must qualify for the DTC or must be an adult who is a dependent due to physical or mental infirmity, and has income that does not exceed the federal basic personal amount for that year;
3. The beneficiary must be the trust settlor, the settlor's spouse/common law partner or former spouse/common law partner, a child, grandchild or great grandchild of the settlor or a spouse/common law partner but not a former spouse/common law partner of a child, grandchild or great grandchild of the settlor.

## Weighing the Pros and Cons of a Henson Trust

Funds from a Henson Trust can pay for expenses of the disabled beneficiary, while allowing that person to continue to receive disability support payments. Further, if the settlor is alive but becomes incapacitated during the lifetime of the disabled person-beneficiary, the Trust may continue to provide for the beneficiary.

As set out above, a Henson Trust that meets certain conditions may also provide tax savings.

A Henson Trust may also have benefits with regard to probate fees for the settlor's estate, when applicable. For more details, the settlor should review his or her particular circumstances with a legal, tax or TD advisor.

One of the difficult elements of establishing a Henson Trust is finding trustees. Siblings of the beneficiary may be the logical choice, but they may not have the willingness or capability to handle the trustee work for their disabled brother or sister. They may also be in a conflict of interest position. For example, any money remaining in the trust may be left to siblings of the disabled individual. If a sibling is the trustee, having absolute discretion on payments to their disabled sibling could be in conflict with their own interest in the trust.

Appointing a corporate trustee, such as a trust company, may be considered.

It would be wise to hire experienced counsel to draft a Henson Trust. If the trust is not constructed properly, its effectiveness will fail and the beneficiary may lose disability support benefits.

A Henson Trust can be a useful tool in planning for a disabled individual, no matter what the settlor's income. However, if the amount put in the trust is insufficient to cover the cost of maintaining the trust, it may not be viable.

On the other hand, the disabled individual's inheritance may far outweigh the combination of funds received from government support and the distributions allowed from a Henson Trust. It should be kept in mind, however, that qualifying for disability support can involve benefits other than money. For example, this could include prescription drug coverage, vision care, disability related benefits such as assistance with hearing aids, employment incentives and benefits and housing-related benefits.

## Consider:

To weigh the pros and cons of a Henson Trust for a disabled child or family member, consider speaking with your TD advisor.



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