Straight Forward

Spring 2019

Henson Trusts: Planning for a disabled child

Wealth Advisory Services, TD Wealth

One of the primary concerns for parents of disabled children is whether they will be able to provide financial support to their child without triggering government clawbacks. There are a few tools parents can use to accomplish this goal. One of them is known as a Henson Trust.

The trust gets its name from a 1987 court case, *Ontario v. Henson*, in which the Ministry of Community and Social Services challenged a trust established in the will of Leonard Henson (although the trust can also be set up while the parent is alive).

Henson intended to create a trust for his disabled daughter, Audra, that wouldn't reduce her benefits under the Ontario Disability Support Program. As such, he gave the trustees absolute discretion to withhold or spend the trust capital and income on Audra's behalf. Audra did not have any legal claim to the funds, and so the Henson family claimed they could not be considered assets.

In court, the Ministry argued that the assets did in fact belong to Audra, and were therefore subject to a clawback. The trial judge disagreed, and in 1989, an appeal by the Ministry was quashed. Unfortunately, by the time the appeal court rendered its judgment, Audra had passed away. However, the legitimization of the Henson Trust created a ripple effect that benefited families with disabled children across Canada.

National Influence

Since the Henson ruling, most provinces have passed legislation allowing individuals to receive discretionary payments from third parties without affecting their entitlement to provincial disability support. In the interim, however, the structure continued to be challenged in courts.

In January of this year, the Supreme Court of Canada (SCC) issued a ruling that provided some clarity around the terms of the structure. According to the SCC, in order for a Henson Trust to be valid, trustees must have complete and unfettered discretion in determining whether to make distributions to the beneficiary. The beneficiary, meanwhile, must not have any legal right to compel a distribution, nor to unilaterally collapse the trust.

The SCC, however, did not rule out the possibility that, in certain circumstances, government programs could still determine these trusts to be assets of the beneficiary, and therefore subject to clawback. 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 distributions. Provincial regulation may also place limits around how discretionary funds can be spent. Typically acceptable expenditures include home care, medical equipment, clothes and chaperoned travel.

It's recommended that parents considering a Henson Trust consult a lawyer who regularly drafts these structures in the province where the intended child-beneficiary resides. Counsel should be able to provide a full picture of the impact of a Henson Trust on the child's continued benefit entitlement.

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In this issue

TD Economics

Economic Outlook: Now is the winter of our discontent

Beata Caranci, Chief Economist, TD Economics

In the past few months, the global slowdown has worsened, prompting more cautious tones from economists and central bankers. Canada has not escaped this growth slump. Economic activity ground to a halt at the end of 2018 under a perfect storm of events, including unexpected production curtailments in Alberta's energy sector.

The production cuts were necessary to stem the supply glut that had dragged prices down to extraordinarily low levels. But, the timing of the curtailments was unfortunate; it happened just as tightened mortgage qualification rules and higher interest rates were biting into housing activity and consumer spending across the rest of the country.

The first-quarter data will likely unveil a similarly challenging economic environment. Production curtailments deepened in the quarter, and the housing market showed only nascent signs of stabilization. A relief valve should open in subsequent quarters as these influences subside. Until this becomes apparent in the data, however, there are bound to be a few months of hand-wringing.

This period will invite further speculation from market pundits on whether Canada has entered a recession. It's important, however, to distinguish between a "true" recession and a "technical" one. A true recession has a combination of depth, duration and breadth, as was the case in 2008 and 1990. Evidence of breadth is the clincher — signs of economic distress and labour-market weakness cutting across industries and regions.

A technical recession, on the other hand, is limited in its scope. For example, during an 18-month period of weakness beginning in 2015, real gross domestic product in Canada contracted in three of six quarters. The interim quarters, meanwhile, offered stagnant growth. If this were merely a tick-the-box exercise, a number of recession conditions would have been satisfied. Economic activity and employment declined, and the unemployment rate moved higher. The year and a half period also meant that the duration was long enough to qualify.

Nationwide, however, the cycle lacked breadth and depth. Excluding Alberta from the equation would have reversed all those trends. In most provinces, the economy continued to grow and create sufficient jobs to push down their respective unemployment rates. So, while Alberta can legitimately claim to have endured a deep and prolonged provincial recession, for Canada as a whole, it didn't meet the criteria of a "true" recession.

A similar outcome is certainly possible this time around, in part because true recessions are exceptionally rare for Canada in periods when the U.S. economy is demonstrating firm underlying domestic fundamentals (as it is now). In fact, such an outcome can't even be found in Statistics Canada's historical data on real GDP, which goes back to 1961. Why not? Because Canada's external sector provides an "escape route," where currency depreciation and healthy U.S. demand boosts exports and tourism enough to offset some of the weakness elsewhere in the economy.

As the old adage goes, the best predictor of future behaviour is past behaviour. But the relationship is not infallible. With each business cycle, the economy evolves. The most obvious difference this time around is the absence of pent-up demand following a long period of household debt accumulation. The second, and less obvious, difference is that Canada's trade dynamics with the U.S. have become more muted relative to past business cycles.

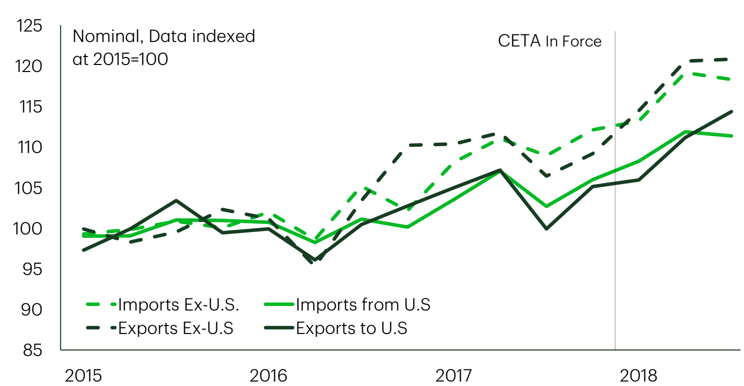
This isn't because of tensions related to NAFTA or because the new Canada-U.S.-Mexico trade deal (CUSMA) remains unratified. The cross-border macroeconomic relationship has weakened for a variety of other reasons. Among them, Canada has lost market share to China and Mexico over the past decade, and companies have increasingly located closer to their demand market. Both outcomes ultimately reduce the sensitivity of Canadian exports to a lower loonie. As a result, the "escape route" created by healthy U.S. demand no longer works as well as it once did.

While we can't completely dismiss the risk of a made-in-Canada "true" recession, it still does not seem to be the most probable outcome. The U.S. trade and currency dynamic is more muted than it has been historically, but it's not dead. This dynamic should still place a floor under the economy, albeit a thinner one.

Moreover, just as trade with the U.S. has evolved over the years, so too has it evolved in other regions. Encouragingly, over the past two years, Canadian exporters have enjoyed increased access abroad — first to Europe, via the Comprehensive Economic and Trade Agreement (CETA), and then, as of January 2019, to many Pacific Rim and South American nations, via the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP). So the traditional escape route may now be taking on a new, more global tradition (see Figure 1).

The core message is that, without a matching contraction south of the border, the risk of a true recession is low. Still, the next few months will prove a bumpy ride, requiring a steady hand from the Bank of Canada. The chance of any further interest-rate hikes this year is remote, even once the data confirm that Canada's growth slump is indeed a thing of the past. □

Figure 1: Canadian Trade

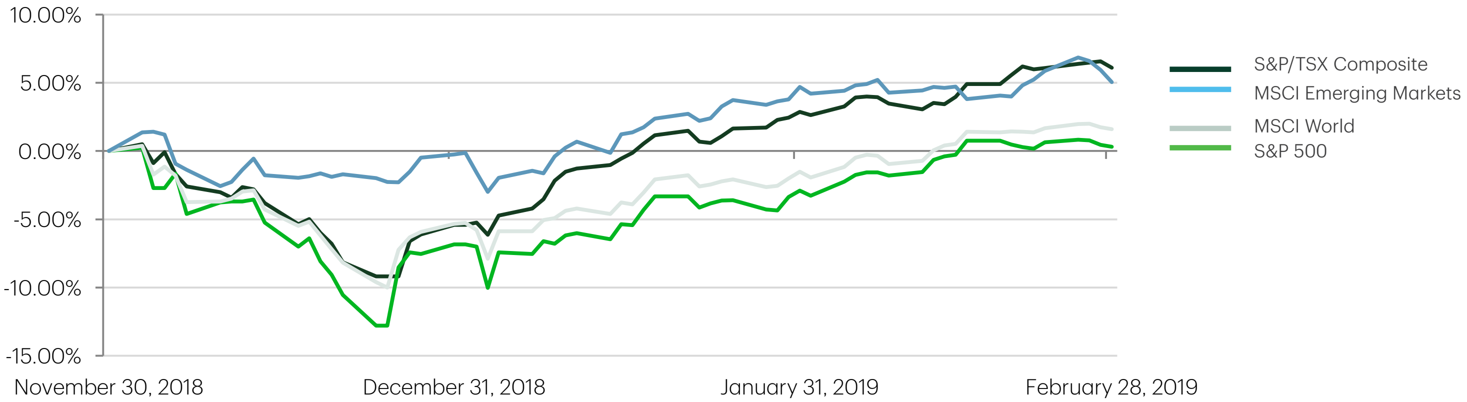


Source: Statistics Canada, TD Economics, as of March 13, 2019.

TD Wealth Asset Allocation Committee

Market Outlook: Spring 2019

Bruce Cooper, CEO and Chief Investment Officer, TD Asset Management, and SVP, TD Bank Group



Source: Bloomberg Finance L.P. as of March 13, 2019; total/gross returns in CAD.

The market correction that happened in late 2018 has become a distant memory as equity markets rebounded sharply off their December 2018 lows. The new year greeted patient investors with a strong start, as most major global markets had already returned mid- to high-single-digit returns by the end of February 2019.

Inflation seems to be having a goldilocks moment — not too hot and not too cold, essentially right on the U.S. Federal Reserve (Fed) target, with little indication it will shift in either direction soon. That should provide the Fed with some reassurance over its recent decision to be patient on monetary policy and await clearer signs in the domestic data about how slower global growth and weaker confidence plays out in the months ahead.

In Canada, sub-par manufacturing performance is still expected in the near term, as we begin to see the impact of Alberta's production curtailment on manufacturing sales volumes. This, combined this with other moderating economic indicators, supports our expectation that the Bank of Canada will remain on the sidelines in the near term, especially in light of the fact that there are no signs of emerging inflationary pressures.

While we remain optimistic on the longer-term outlook for equities, we do believe that periods of volatility may continue as the market contends with central bank policy and growth concerns. Global leading economic indicators have moderated, leading to an increase in concerns about global growth and earnings. Regionally, we believe that U.S. relative economic strength should continue and that it presents less risk than international equities. We have a growing preference for quality companies with strong balance sheets as the 2019 macro and earnings outlooks become more uncertain.

The late 2018 correction also created opportunities in the fixed-income space. Corporate bond prices edged lower as investors moved to the safety of government bonds, making corporate bond yields (which move opposite to bond prices) even more attractive than comparable government bonds. We continue to believe that corporate bond yields are attractive given our macro outlook.

Overall, our macro themes remain consistent. Yields and expected returns remain in the low single digits as our "lower for longer" theme remains in place. We currently do not expect a recession to materialize this year and feel the risk of this is low. While global growth is likely to continue to slow, there are fewer imbalances in the broad economy today to trigger a recession than in the recent past.

Looking ahead, we will continue to monitor several risks in 2019. Persistent trade frictions between the U.S. and China, slowing global growth and central bank actions could all have implications for financial markets. Continued protectionist measures caused by escalating trade frictions could dampen economic growth and result in higher inflation, placing downward pressure on equity valuations.

Additionally, there is always the risk that central banks will commit a policy error as they reduce their accommodation. Tightening monetary policy to more normal levels, without adversely affecting economic growth or threatening financial stability, is a delicate balancing act. Policy change that is too aggressive remains a possibility and could create volatility and a difficult environment for investors. These all remain key risks to global growth that we will continue to closely monitor.

Steady hands are paramount during periods of volatility as we focus on companies we believe to be at the high end of the quality spectrum — particularly those that generate substantial free cash flow and return that cash to shareholders through rising dividends over time.

We continue to believe that a balanced approach is warranted at this time and continue to favour a diversified portfolio that includes: (1) high-quality equities that may have the ability to increase their earnings and dividends in a low-growth environment, thereby helping to protect the real value of investors' savings; (2) an allocation to high-quality corporate bonds, including both investment-grade and high-yield, to help provide some income, diversification and stability. □

Henson Trusts: Planning for a disabled child (continued from page 1)

Tax Treatment

Trusts are separate taxpayers from the named beneficiaries, and must therefore file a separate income tax return. Income retained in the 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 a few exceptions to the rule that that requires taxation of trusts at the top marginal rate, including two that are available specifically for disabled individuals. The first is known as a "qualified disability trust" (QDT). This is a testamentary trust (i.e., a trust established in a will) that annually elects with the beneficiary for the trust to be deemed a QDT. The income held with 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. 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.) The electing beneficiary must have been specifically named as the beneficiary in the document (e.g., the will or trust document) that established the trust. The election must include the electing beneficiary's social insurance number. The electing beneficiary must not make a QDT election with respect to any other trust. The trust must not be subject to the federal recovery tax for the year. The trust must be resident in Canada throughout the year.

The second exception 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. The beneficiary must be resident in Canada. 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. The beneficiary must be the trust settlor; or the settlor's spouse or common-law partner or former spouse or common-law partner; or a child, grandchild or great grandchild of the settlor or a spouse or common-law partner (but not a former spouse or common law partner) of a child, grandchild or great grandchild of the settlor.

Parents considering the tax implications of a Henson Trust are advised to speak to a lawyer with experience in the area.

Pros and Cons

Aside from a lower tax rate in certain circumstances, as set out above, Henson Trusts provide a number of benefits. Funds from the trust can, of course, pay for the beneficiary's expenses, while allowing that person to continue to receive disability support payments. The trust may also continue to provide for the beneficiary if the settlor becomes incapacitated. A Henson Trust may, in addition, lower probate fees for the parent's estate, when applicable. (For more details, the settlor should review his or her particular wealth circumstances with a legal, tax or TD advisor.)

One of the more difficult decisions when it comes to establishing a Henson Trust is finding suitable trustees. Siblings may be the logical choice, but they may not be willing or able to handle the work. They may also find themselves in a conflict of interest if, for example, they are in line to inherit the trust assets upon the passing of their disabled sibling. Appointing a corporate trustee, such as a trust company, may be an option, but the fees involved may be considerable.

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

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