LIFESUPPORT

A Henson trust keeps government supports intact for disabled heirs.

By John Poyser

Illustration by Carey Sookocheff

Most of your clients have estate planning wishes for their children: Give the house to the eldest daughter, the farm should be split among all four kids and so on.

Leonard Henson wanted his entire estate to be passed onto his daughter, Audra, but it wasn't that easy. The biggest issue for him was that Audra was disabled.

If Audra became the sole beneficiary of the estate and therefore "owned" significant assets and/or property, the government would consider her ineligible for the social assistance payments she had been receiving and would cut Audra off. But the regulations did allow for Audra to have some money in hand, and did not hold it against a disabled person when a third party provided a discretionary benefit.

This was the thinking Henson had when he drafted his will in 1978. The will transferred his estate to three trustees to be held on Audra's behalf. The trustees had the discretion to withhold or spend the income and capital to best serve Audra's interests. Money from the estate could be used to buy her a TV or new clothes, or pay for a chaperoned trip to visit a relative. Because these payments are considered discretionary benefits, she still qualified for government support.

What the will didn't do was give Audra a legal claim to demand money. This meant the government could not treat the money as hers after she inherited it.

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The government still tried to withdraw Audra's social assistance after Henson died, but the Ontario Court of Appeal ruled that Audra was eligible and ordered the payments be reinstated. It was a hollow victory for Audra—the court case took years and she died before the Court of Appeal could rule in her favour.

But it was a significant victory for the disabled. The trust Henson set up for Audra has come to be known as a "Henson trust." Now lawyers use Henson trusts across Canada when making arrangements for disabled beneficiaries.

How it Works

For a Henson trust to be effective, trustees must have full discretion to distribute the trust's income and capital to the beneficiary as they see fit. More important, they must have the power to *withhold* the income and capital—this is the core of the Henson trust.

The beneficiary gains no vested right to income or capital under the trust. She cannot claim payments from the trust, she cannot demand them, and she does not, as a result, own the contents of the trust. The will should be worded to provide complete discretion to pay out or withhold income or capital.

The trust can take the form of a testamentary or an *inter vivos* trust and the tax treatment is generally the same. The trust is taxed as a separate taxpayer and files its own return each year. Testamentary trusts are taxed at graduated rates, while *inter vivos* trusts are taxed at top income tax rates at every dollar of income.

But there is one major exception to this tax treatment: the availability of the preferred beneficiary election. According to the Income Tax Act, the preferred beneficiary election is available when the beneficiary of a trust is suffering from a severe and prolonged mental or physical impairment. The beneficiary also has to be related to the person establishing the trust (referred to as the "settlor" in trust law). They

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FRAGILE STRUCTURE

Each province has its own views and rules on the Henson trust.

PROVINCE	STATUS OF HENSON TRUST
Northwest Territories	Challenged; current laws do not permit Henson trusts
Nunavut	Challenged; current laws do not permit Henson trusts
British Columbia	Active
Alberta	Defunct
Saskatchewan	Active
Manitoba	Active
Ontario	Active
New Brunswick	Active
Nova Scotia	Active
Prince Edward Island	Active
Newfoundland and Labrador	Challenged; any trust settled with more than $100,000 makes beneficiary ineligible for support

Sources: *NWT & Nunavut: Cynthia Levy, Davis & Company; B.C.: Lauren Blake-Borrell, Davis & Company; Man.: John Poyser, Inkster Christie Hughes; Alta.: Douglas Gorman, Davis & Company; Sask.: George Nystrom, Balfour Moss; Ont.: Patricia Robinson, Goodmans LLP; N.B.: Gerald McMackin, Stewart McKelvey Stirling Scales; N.S.: Timothy Matthews, Stewart McKelvey Stirling Scales; P.E.I.: Thomas Matheson, Cox Hanson O'Reilly Matheson; Nfld.: Meg Gillies, Stewart McKelvey Stirling Scales.*

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can be a spouse or common-law partner of the settlor (or former spouse or common-law partner), child, stepchild, grandchild, step-grandchild, great-grandchild or step-great-grandchild of the settlor.

Where a person qualifies as a preferred beneficiary, a joint election can be filed by the trust and the preferred beneficiary, or their legal decision maker. By making this election, the beneficiary is taxed on the income in the trust even though those amounts were retained in the trust and were recapitalized rather than paid out to the beneficiary. In short, the income stays in the trust but is taxed as if it had been paid out to the beneficiary.

The preferred beneficiary election removes the common impediment identified by planners when considering an *inter vivos* trust. Generally, an *inter vivos* trust is taxed on each dollar of income at the highest federal and provincial tax rates. With the preferred beneficiary election, the income can be taxed on the tax return of the beneficiary, taking advantage of lower tax rates in lower tax brackets.

In a testamentary trust, income can be split between the trust and the disabled beneficiary in such a way as to double the amount of income that can be enjoyed at the lowest federal and provincial tax rates.

> Assets left to grow in a Henson trust can become substantial.

The Planning Opportunities

If a client has a modest amount and wants to settle it into a Henson trust, he can place a relatively modest amount in a trust, whether *inter vivos* or testamentary, and improve the lifestyle of that beneficiary while sustaining their provincial entitlement for government support. The preferred beneficiary election, where available, will ensure the income is always taxed under the graduated tax system.

A client might settle a larger amount into a Henson trust and intend that it be used over the short term to pay for extras such as a personal care attendant or wheelchair lift and improve the standard of life for the disabled person. The long-term goal, however, might be to ultimately have that individual freed from government support and provided for at a higher level. Assets left to grow for a decade or longer in a Henson trust can become substantial.

If the trustees conclude the beneficiary's standard of living can be significantly improved by sole reliance on funds within the trust, the trustees may simply begin to pay out the income at a level that will disqualify ongoing social assistance. The idea here is to subsidize the growth of the fortune with government support until the government can be relieved of its role entirely.

It also answers the common criticism that a financially stable person should not be dipping into social programs. But this is an area where families are advised to tread cautiously. Some government programs available to qualifying individuals are irreplaceable and cannot be purchased once the disabled person elects out of the program.

Despite regulatory and policy challenges, Henson trusts remain one of the mainstays of estate planning for the disabled. **AE**

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