Using a Henson Trust as a complement to an RDSP

Francois Bernier
Director, Tax and Estate Planning

Before the government introduced Registered Disability Savings Plans (RDSPs), in most estate planning situations parents with a disabled child would hold assets and inheritances in trust. This option was often referred to as a "Henson Trust," based on the court case that formalized the strategy. But it's important to know that RDSPs have not made this kind of trust obsolete.

What is a Henson Trust?

The "Henson Trust" is named after Audrey and Leonard Henson. Audrey, the daughter of Leonard Henson, was mentally disabled and receiving income support from the Province of Ontario.

Leonard wanted to make sure his daughter was cared for following his death. He drafted a will that established a trust to hold her inheritance. The trust created in the will was completely discretionary, meaning the trustees could make payments to Audrey to improve her lifestyle at their own discretion. Audrey did not have any right to claim any payments from the trust. In addition, the trustees could refrain from making any payment to Audrey if they felt that it would disqualify her from government support.

When Leonard passed away, Ontario Social Services ended Audrey's government support, stating that the trustees should support her until the whole inheritance was gone. She could then re-apply for income support once all the funds from her trust were depleted.

The trustees fought the government and the case ended up in the Ontario Court of Appeal. In September 1989, the Court ruled that a disabled person could inherit an amount placed in a discretionary trust and could still remain eligible to receive government support. Funds placed in such a trust would not have to be liquidated before the person could receive disability support.

Impact of a Henson Trust on disability payments

A Henson Trust is still an effective tool when planning for individuals who have a disability and are receiving disability payments as income support.

Throughout Canada, except in Alberta, the Northwest Territories and Nunavut, if an individual is receiving disability payments, the assets held in the trust do not affect their government benefits.

Newfoundland and Labrador recognize the Henson Trust, but limit assets in trusts to $100,000 before the beneficiary's social assistance benefits are affected.

Also, some provinces, including Ontario, allow payments to be made from these trusts for disability-related items, such as caregiving and assistive devices, without any effect on the payment of benefits. However, when withdrawals are made for non-disability expenses (such as food, clothing, shelter, etc.), they are classified as income and may affect income-tested benefits.

Benefits of a Henson Trust

Aside from protecting disability benefits, there are other advantages associated with the use of Henson Trusts.

First, RDSPs have a contribution limit of $200,000. A Henson Trust may make sense if a dependent child inherits more than $200,000 from a deceased parent's RRSP, RRIF or RPP. A maximum of $200,000 can be rolled over to an RDSP and the remaining inheritance can be transferred to the trust allowing the inheritance to be fully invested without affecting social benefits. Alternatively, the Henson Trust can be used by the trustees to "stream" contributions into an RDSP for the beneficiary. This can both protect the assets and allow the beneficiary to take advantage of the government matching grants and bonds, thereby increasing his or her wealth.

Second, funds contributed to a RDSP are irrevocably donated to the beneficiary. They cannot be "taken back" by the donor and will pass through the beneficiary's estate on death of the beneficiary either under a will or by way of provincial intestacy laws (which deal with the distribution of estate assets when there is no will). With a Henson Trust, you can designate a residual beneficiary of the trust when the disabled individual passes away. This is especially useful for a beneficiary who is not mentally capable of establishing a will.

A further reason to use a Henson Trust is to control access to funds and provide good management of the assets. This could be desirable in the case of a beneficiary who is not mentally capable, financially savvy or has poor lifestyle habits (i.e., spendthrift).

Finally, a Henson Trust offers flexibility. If government grants and/or bonds are

received in an RDSP within 10 years of an RDSP withdrawal, the grants/bonds received during that 10-year period will have to be paid back to the government. Henson Trusts do not have this requirement, and consequently might be a better option for short-term withdrawals. With that said, it is important to keep in mind that, unlike RDSPs, contributions to Henson Trusts do not attract government grants and bonds, and withdrawals from a Henson Trust will normally affect an individual's income-tested benefits.

How to set up a Henson Trust

A Henson Trust can be set up for any disabled individual. It is more costly and complex to set up than an RDSP, and you will need the legal advice of a lawyer who, preferably, has experience in this field.

The trust can be created by the donor/settlor while alive or at the time of death. Trusts created while alive would be treated as intervivos trusts for tax purposes; that is, all income and growth generated by investments held inside the trust would normally be taxed at maximum marginal rates. If the beneficiary is a minor, it may be preferable to hold investments that produce capital gains, to avoid taxation to the settlor by way of attribution rules. Also, in the case of intervivos trusts, a person other than the settlor will have to be appointed trustee (i.e., a relative or close friend), to avoid the effect of section 75(2) of the Income Tax Act (Canada) and the taxation of all income and capital gains to the settlor.

A Henson Trust can also be established in a will. It would then be treated as a testamentary trust, allowing it to be taxed at progressive tax rates.

Henson Trust and RDSP

RDSPs and Henson Trusts are complementary tools. In some situations, one might be better than the other. In other cases, both can be used at the same time.

Individuals should consider the benefits of RDSPs and Henson Trusts based on their own set of circumstances. When considering which tool to use, in many cases, the winning strategy involves the use of both tools. The benefits of RDSPs and Henson Trusts can be used together to maximize support for disabled individuals.

Ask your Sales Team for a copy of our Strategy Lab White Paper on Wealth Planning for the Disabled.