RDSPs Versus Trusts

By Jack Styan

Should you open an RDSP or set up a Trust?

The short answer is that you can, and probably should, use both two vehicles. They have different purposes, rules and different interactions with provincial and federal benefits and supports. You will need to get a bit of knowledge so that you are comfortable in making decisions. Let's get you started.

The Registered Disability Savings Plan

Overview

There are very few downsides to opening an RDSP so we would recommend that most people, if they are eligible, should open one as soon as possible. In launching the RDSP, the federal government created a powerful savings vehicle for people with disabilities. Up to $70,000 in federal government money is available as an incentive for saving, and up to $20,000 is available for people with lower incomes who don't have money of their own to contribute. The lifetime limit for non government contributions is $200,000. The growth of funds within the RDSP is tax deferred; the growth and government portion of the RDSP is taxable in the hands of the beneficiary upon withdrawal. Because anyone can make contributions, the RDSP provides an ideal method for family and friends to assist. Furthermore, the RDSP can be readily used to complement a person's provincial disability benefits, because provinces have made provisions to exempt the RDSP.

The eligibility for opening an RDSP is straightforward:

- Eligible for the Disability Tax Credit
- Has a valid social insurance number
- A Canadian resident
- The year in which the beneficiary turns 59 has not ended.

We would add that federal government contributions are only available until December 31st of the year in which the beneficiary turns 49.

Considerations

If the purpose of opening a plan is to take advantage of the federal government incentives then you should be aware that you are making a long term investment. In general, people will want to wait to access the funds for 10 years after the last federal government contributions because of the holdback amount. The holdback amount is the total of federal government contributions made in the previous ten years. This amount must be repaid when a withdrawal is made from an RDSP. Of course, after ten years the holdback amount is zero and no money is repayable. After many years, if an RDSP has grown to several hundred thousand dollars, and the holdback amount is only a few thousand dollars, you may be comfortable giving up the holdback amount to access the funds in your RDSP. In general, however, the RDSP is not a good place to make a short term investment if you want to utilize the federal government contributions.

If you are planning for an adult relative, and you are concerned about their ability to manage their money, special planning is required. The RDSP belongs to the beneficiary and if they are an adult when the RDSP is established, then they or a legal representative must be the Holder of the RDSP. The Holder is the person who makes investment and withdrawal decisions. Unfortunately the rules governing legal representation differ from province to province. In most provinces the choices for legal representative are Power of Attorney or Adult Guardianship. BC has a special tool called a Representation Agreement. PLAN, CACL and the RDSP Resource Centre are all working with provincial and federal governments to seek solutions that will make it easier and more secure to use an RDSP in these situations.

Trusts

Overview

Unlike RDSPs, trusts are not savings vehicles. Rather, trusts are useful vehicles in which to place money or property for the use of a relative with a disability. A trust is a relationship where a trustee holds money or other assets for the beneficiary. The person who owned the assets originally is known as the settlor. (In some circumstances, the trustee, beneficiary and settlor may be the same person.)

People with disabilities and their families have found trusts to be extremely useful for several reasons.

- Flexibility – When you establish a trust you make the rules that govern it: who and what the funds should be used for, who makes decisions about investment and disbursements, who gets the assets if something happens to the beneficiary. In addition, there are no constraints (unless you build them into the trust)
- Security – In designing the trust and choosing the Trustee(s), you can create a very secure situation. If you are designing a discretionary trust, you need to be aware that you must give your Trustee the power to make decisions but remember, you get to choose who makes decisions and who replaces the Trustee if they are no longer willing or able to act in that role.
- Avoiding probate – When assets are place in trust prior to the settlor dying, they are passed to the beneficiary without being subjected to probate. Funds that are placed in an *inter vivos*trust (a trust set up while the person setting it up is alive) are also not subject to challenge through the Wills Variation Act (BC) or similar legislation in other provinces.
- Exemptions with respect to provincial disability benefits – Where people don't qualify for an RDSP, then a trust is the only other vehicle that can be used for saving or holding an asset without losing eligibility for provincial disability benefits. Discretionary trusts are exempt for the purpose of qualifying for disability income benefits in all provinces (except maybe in Alberta, where I've heard differing opinions about interpretation of the regulations). This means that a family can put any amount in a discretionary trust without affecting the disability benefits of the beneficiary. Non-discretionary trusts are exempt to a certain

amount (e.g. $100,000 in British Columbia). Getting money out of trusts to assist the beneficiary is a bit more challenging. For example, in BC any amount can be spend on disability related supports, education or training, maintenance on a home, renovations to make a home accessible and an amount of $5,484 to assist a person's independence. Beyond this amount, disbursements are deducted from the following month's income. The rules around treatment of income and disbursements from trusts by disability benefits programs differs significantly from province to province so you need to check out the rules for your province. In every province, however, they are more restrictive than those governing the RDSP!

Considerations

Unlike an RDSP, a trust can be established for any person of any age. If you are not able to open an RDSP, then a trust might be the only vehicle available to you. There are a number of other situations, however, in which they can be particularly useful.

- Settlements and Inheritances – Where a person receives a sum of money directly through an inheritance or settlement, many provinces will permit the person to place the funds in a trust and still be eligible for disability benefits. This may also be necessary if the amount of money a person receives exceeds the amount that can be placed in an RDSP ($200,000).
- For immediate use – If a family wants to complement provincial disability benefits immediately, it may make sense to use an *inter vivos* trust. For example, a trust could be set up to provide for a beneficiary's financial security for the more immediate future with little or no impact to their disability benefits, until funds in an RDSP become available. The downside, which could be important for larger amounts of money, is that taxes on income generated in *inter vivos* trusts are usually taxed at the highest marginal rate.
- Estate planning - In planning for the distribution of an estate, a trust often makes more sense than an RDSP, especially for larger estates. While there is no limit on how much can be placed in trust, only $200,000 can be placed in an RDSP. Property can be placed in trust but not in an RDSP. Funds can be used for the beneficiary completely at the discretion of the trustee. Although there are no withdrawal restrictions or formula governing trusts, people should be aware that in every province, disability benefits programs restrict the expenditures that can be made from trusts without reducing the income received from the program. Equally important, the settlor of a trust gets to decide what happens to the assets held in the trust when the beneficiary dies. With an RDSP, the assets pass through the beneficiary's estate. The only downside for this purpose is that disbursements from trusts don't receive as favourable treatment as disbursements from RDSPs. We would also point out that the RRSP/RRIF rollover to an RDSP should be considered in estate planning.

If you are interested in learning more about trusts, we'd recommend PLAN's Wills, Trusts and Estates Seminar and if you are considering setting one up, that you sit down to discuss the options and pros and cons with a knowledgeable lawyer.

In Conclusion

As pointed out above, there are some black and white situations where you should use a RDSP or a trust but there is also a lot of grey area. We have four recommendations:

- Get educated – the more knowledge you have the better decisions that you will make
- Review your situation to ensure that you are maximizing your tax benefits
- Make a financial savings plan and include an RDSP (in most cases) in your plan
- Meet with a knowledgeable lawyer to discuss your estate plan.

RDSP resource centre

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