Reference Guide

PLANNING FOR A PERSON LIVING WITH A DISABILITY

WEALTH PLANNING GROUP

Assante® PRIVATE CLIENT

This reference guide is intended to provide information and guidance for those whose lifetime planning and/or estate planning objectives include providing for an individual who has special needs because of either a mental and/or physical disability.

While issues relating to planning for a person with special needs typically include personal matters such as ongoing care and living arrangements, the focus of this Reference Guide is on the financial aspects of the person's life - that is, how to most effectively provide lifetime financial security for the person with special needs.

For the purposes of this reference guide, a "person with special needs", "individual with special needs", "child with special needs" or "beneficiary with special needs" is an individual who is dependent on others as a result of mental and/or physical disabilities. As noted below, somewhat different terms are used for tax purposes.

While this reference guide generally deals with how parents could plan for a child with special needs, many of the same considerations would apply equally to any relative or friend who would like to provide for a person with special needs.

OBJECTIVES OF PLANNING FOR A PERSON WITH SPECIAL NEEDS

Typically, those wishing to provide financial security for a person with special needs will want to achieve one or more of several objectives. These might include the following:

- **Ensuring that the person with special needs has enough financial resources for his or her life**

  This is typically the primary objective of most individuals who wish to provide for a person with special needs. To the extent possible, the desire is to ensure that the person with special needs has enough resources available for his or her lifetime for appropriate housing, food, clothing, and other needs.

- **Protecting social assistance benefits**

  Often an important aspect of planning for a person with special needs involves trying to ensure that the individual will be eligible to receive provincial social assistance benefits and accompanying health care and other benefits. Generally, under most provincial assistance programs, an individual's entitlement to benefits can be terminated or reduced based on the availability of other financial resources such as other sources of income or assets in excess of certain stipulated amounts.

- **Protecting the individual and his or her assets**

  Depending on the nature and extent of the disability, a person with special needs may lack sufficient knowledge or ability to effectively manage his or her financial affairs, or may be vulnerable to the influences of others, to his or her detriment. As a result, parents planning to provide for a child with special needs, typically want to ensure that appropriate measures are in place to protect the child's assets.

- **Minimizing taxes**

  Although not typically the primary concern when planning for a person with special needs, minimizing taxes for the parent and/or child can sometimes be a secondary objective, to ensure more financial support is left for the child with special needs.

Depending on the specific objectives and circumstances of the parent(s) planning for a child with special needs, some measures might be implemented during the lifetime of the parent(s), while others may be put in place to take effect only on the death of the parent(s).

PLANNING OPPORTUNITIES RELATING TO A CHILD WITH SPECIAL NEEDS DURING THE LIFE OF THE PARENT(S)

Most often, parents of a child with special needs focus their planning on how to provide for the child once the parents have died. There are, however, some strategies or planning opportunities that can be considered while the parents are alive.

Using a Lifetime Trust

Creating a lifetime trust for the benefit of a child with special needs can be an effective way for parents to provide financial support for the child during the lifetime of the parent(s).

Please refer to our reference guide on family trusts, which sets out the key benefits of lifetime trusts. It also includes important information on the taxation of such trusts, including the income tax attribution rules, and guidelines regarding the planning of lifetime trusts.

Briefly, to create a lifetime trust for one or more beneficiaries, a person, referred to as a settlor, transfers legal ownership of property to one or more trustees, and provides instructions to the trustees regarding how the property is to be used for the benefit of the beneficiary or beneficiaries. This would all be set out in a trust agreement. In the case of a lifetime trust for a child with special needs, often the settlor might be one or both parents or a grandparent or other relative of the child.

Using a lifetime trust to provide for a beneficiary with special needs offers several benefits, including:

- **The ability to protect the assets for the benefit of the child with special needs.** This is particularly valuable if a child with special needs is not capable of managing financial matters or if there are concerns that the child may be easily influenced by others to give away or otherwise deal with money in a way that would not be in his or her best interests.

- **The ability to take advantage of the preferred beneficiary election, if certain conditions are met.** This election would allow accumulating income in the trust to be taxed as income of the beneficiary with special needs, rather than income of the trust (where it would otherwise be taxed at the top marginal rate). Since there is no requirement that the income actually be paid to the beneficiary, the trustees could then leave the income in the trust for use in the future (subject to possible concerns in those

provinces where the maximum period of income accumulation is 21 years). Alternatively, the trustees could pay the income to or for the benefit of any beneficiary of the trust. This election is explained in more detail below.

- **The potential to split income with the child with special needs.** This would enable the parent(s) to reduce taxes, if the child is in a lower income tax bracket than the parent(s). Note, however, that the attribution rules under the *Income Tax Act* (referred to earlier and explained more fully in our reference guide on family trusts) may eliminate this possible benefit in certain situations.

- **The reduction of probate fees on death.** The assets that are transferred to a lifetime trust would no longer belong to the parent, so they would not be part of the estate of the parent on his or her death and therefore, probate fees would be reduced. (It should be noted, however, that taxes may be payable when establishing the trust if there are unrealized capital gains on the assets transferred to the trust.)

- **Continuity for the beneficiary.** Having a trust in place during the parent's lifetime enables the parents to act as trustees and to manage the assets for the benefit of their child with special needs. When the parents die, or are no longer capable of managing the trust, replacement trustees would step in to act in their place, which should mean little disruption for the child.

- **The ability to protect ongoing social assistance benefits for the child with special needs.** The use of a trust for a beneficiary with special needs, whether a lifetime trust or a testamentary trust (that is, a trust that arises on death, which is discussed in greater detail below), can help to ensure the continuation of social assistance benefits and related health care benefits for the child.

  An effective way to accomplish this is for the trust provisions to be drafted in a manner that ensures that the child with special needs is not in any way entitled to receive any income or capital from the trust. Instead, the trustee(s) of the trust should be given absolute discretion regarding payments out of the trust to or for the benefit of the beneficiary with special needs, including the ability to decline to make any such payments. A fully discretionary trust such as this is often referred to as a Henson trust.

  It is important to note, however, that there is a growing concern among provincial social assistance agencies across the country regarding the use of a Henson trust to provide for a child with special needs. . As a result, there are continuing efforts to challenge the effectiveness of such trusts, or to put laws or regulations in place that would enable the agency to take into account assets held in a discretionary trust for a beneficiary with special needs in assessing entitlement to social assistance benefits. . In some provinces, for example, there may be limits on the size of the trust and/or restrictions regarding the amount or nature of payments out of the trust to or for the child's benefit. There are also limits on how much the child with special needs may own directly before his or her benefits can be affected. These rules must therefore be carefully explored when planning a discretionary trust for a beneficiary with special needs.

One strategy that has been suggested to avoid a successful challenge of a Henson trust is to name not just the child with special needs as the beneficiary of the trust but also other individuals (such as the child's siblings or other family members) as potential income and capital beneficiaries. This would negate any contention that the trust was strictly for the benefit of the child with special needs, which would make it more difficult for the agencies to successfully maintain that the assets in the trust should be considered to be assets of the child with special needs. However, this strategy would not be possible for a lifetime benefit trust, which is a type of trust used to manage registered retirement plans for the benefit of a child with special needs once the parent(s) have died. Retirement plans and lifetime benefit trusts are discussed in more detail below. When planning a lifetime trust for a beneficiary with special needs, the trustees of the trust should be carefully considered. See below for more information on this subject.

Legal Decision-Making Authority for the Child

Generally, the parents of a child with special needs are able to make most decisions on behalf of the child while the child is under the age of majority. In some provinces and in certain situations, however, the parents must apply to court in order to be given legal authority to look after the assets of a minor child, whether the child is disabled or not.

Once the child becomes an adult, the role of the parent(s) ends. This gives rise to an important concern for the parents: Who will have the legal authority to make decisions on behalf of their child with special needs?

If the adult child has sufficient mental capacity, he or she may be able to make certain decisions on his or her own, or with some guidance. However, it would be advisable for the child to also have the following documents prepared:

- A power of attorney for property (depending on the province or territory, this document may be called an enduring power of attorney, or a mandate for property in Quebec or simply a power of attorney). This document would name one or more other individual(s) to look after the child's financial matters in the event the child later becomes incapable of doing so.

- A power of attorney for personal care (also known as a health care directive, an advance directive, a representation agreement or other similar terms). This document would typically name one or more individuals to make personal health care decisions on the child's behalf in case the child becomes unable to make or communicate his or her own decisions on such matters.

- A will. This would ensure that assets that the child may acquire during his or her lifetime will be distributed in accordance with the child's wishes, rather than based on a provincial formula that applies in situations where there is no will.

Where the child lacks sufficient mental capability to have such documents prepared, a different approach is needed. In such a case, a parent or other suitable person would have to apply to court to be given legal authority to look after the child's financial affairs and personal care decisions. This proceeding is sometimes referred to as an application for guardianship or committeeship. If

no application is brought by close family members or friends, the Public Trustee or similar provincial authority may end up looking after the person with special needs' financial affairs, which is often not considered to be a desirable situation.

Planning for the parent's possible future disability

A parent who provides ongoing financial support to a child with special needs should have a power of attorney for property (or comparable document applicable in the parent's province or territory) in place in case the parent becomes unable to act in the future. This document should clearly give the named attorney the authority to use the parent's funds to provide for the child with special needs. If the document does not specifically authorize the parent's attorney in this manner, the attorney may be prevented by law from using the parent's financial resources to assist in the child's care.

Maximizing available tax credits

There are a number of tax credits that may apply to a person with special needs. Some of these may be claimed by the individual in his or her own tax return; others may be transferred to the spouse or parent of the person with special needs or be claimed by the spouse or parent directly. These tax credits are non-refundable tax credits. That is, they may reduce taxes payable to nil, but would not generate an income tax refund. Professional accounting advice should be obtained to ensure that these tax credits are maximized.

Possible savings on excise tax, GST/HST and customs duties

In certain circumstances, an application for a refund may be made for part of the federal excise tax paid on gasoline purchased for the transportation of an individual with special needs.

GST / HST may also not be payable on certain goods and services used by individuals with disabilities. As well, certain goods specifically designed for use by individuals with disabilities may be brought into Canada duty free.

PLANNING OPPORTUNITIES TO PROVIDE FOR A PERSON WITH SPECIAL NEEDS ON THE DEATH OF THE PARENT(S)

Using a testamentary trust

The use of a testamentary trust, and in particular a fully discretionary testamentary trust, is often an ideal way to provide for a child with special needs on the death of the parent(s). Often referred to as a Henson trust (named for the landmark Ontario court case that confirmed the effectiveness of such a trust), a fully discretionary testamentary trust is a trust usually created by will that takes effect on death and gives the trustees complete discretion regarding distributions of the income and capital of the trust. This broad discretionary power enables the trustees to decide each year what amount, if any, of the income or capital is to be paid to or for the benefit of the beneficiary.

For greater clarity, the provisions of a Henson trust typically state that the beneficiary is to have no interest whatsoever in the income or capital of the trust and is not entitled at any time to any amount out of the trust. Accordingly, the beneficiary would only acquire an interest in amounts that were actually paid out of the trust to him or her (or to others for the beneficiary's benefit) or in property that was purchased for the beneficiary by the trustees.

In the case of a beneficiary with special needs, the benefits of a fully discretionary testamentary trust would include:

- **The ability to protect the assets for the benefit of the child with special needs.** As outlined earlier, this is particularly valuable if a child is not capable of managing financial matters or if there are concerns that the child may be easily influenced by others to give away or otherwise deal with money in a way that would not be in his or her best interests.

- **The ability to take advantage of the preferred beneficiary election**, if certain conditions are met. As also noted earlier, the preferred beneficiary election would allow accumulating income in the trust to be taxed as income of the beneficiary with special needs, rather than income of the trust (where it would otherwise be taxed at the top marginal rate, unless the trust qualifies as a qualified disability trust - see below for an explanation of qualified disability trusts). Since there is no requirement that the income actually be paid to the beneficiary with special needs, the trustees could then leave the income in the trust for use in the future (subject to possible concerns in those provinces where the maximum period of income accumulation is 21 years). Alternatively, the trustees could pay the income to or for the benefit of any beneficiary of the trust. This election is explained in greater detail below.

- **The ability to save on taxes, if certain conditions are met.** Generally, all income retained in a trust is taxed at the top marginal rate. However, there are limited circumstances where a testamentary trust can benefit from its own set of marginal tax rates. One of those circumstances is a testamentary trust for the benefit of a person who qualifies for the disability tax credit (among other requirements) and is referred to as a qualified disability trust. Qualified disability trusts are discussed in greater detail below.

- **The ability to have social assistance benefits continue for the child with special needs.** A properly drafted fully discretionary trust, whether created as a lifetime trust or as a testamentary trust, that gives the trustees complete flexibility regarding payments to or for the benefit of a child with special needs, can enable the child to continue to receive social assistance benefits and accompanying health care and other benefits. The same concerns regarding the use of trusts in the context of social assistance benefits under the heading *Using a lifetime trust* should also be considered for a testamentary trust.

When planning a testamentary trust for a beneficiary with special needs, the trustees of the trust should be carefully considered. See below for more information on this subject.

Qualified disability trusts

As previously discussed, unlike most other trusts, all income retained in a qualified disability trust (QDT) will be taxed at its own set of graduated marginal tax rates. This can be a significant tax advantage where income can be split between the QDT and the beneficiary with special needs or any other beneficiaries of the trust.

In order for a trust to qualify as a QDT and therefore benefit from its own set of marginal tax rates, the following requirements must be met:

- the trust must have arisen on and as a consequence of death (in other words, it must be a testamentary trust);
- the trust must be a resident of Canada for the year;
- the trust must include with its income tax return, an annual election, made jointly with a beneficiary with special needs (or the beneficiary's legal representative)
- the beneficiary with special needs must qualify for the disability tax credit; and
- the beneficiary with special needs must not have elected with any other trust.

Since there can only be one QDT per beneficiary with special needs, a parent planning for a child with special needs will want to determine whether other family members are also planning to provide for that child by using testamentary trusts and co-ordinate his or her planning with them. However, a QDT can have other beneficiaries in addition to the beneficiary with special needs.

In any year that the trust elects to be a QDT, it is subject to graduated tax rates. However, it may be required to pay a recovery tax related to previous years if none of the beneficiaries at the end of the year was an electing beneficiary of a previous year, if the trust ceases to be a resident of Canada, or if a capital distribution is made to a non-electing beneficiary. Income distributions to non-electing beneficiaries are permitted.

Since a QDT is subject to its own set of graduated tax rates, it is often beneficial to have income accumulate in the trust. However, some provinces have rules against accumulation which requires the income in the trust to be distributed after a certain number of years. If applicable, these rules should be considered as they may affect the beneficiary's ability to receive social assistance.

Dealing with the home

If a child with special needs lives with his or her parent(s), the parent(s) may wish to arrange for the home to be available for the child after their death(s).

In some provinces, a principal residence is excluded when calculating a person's entitlement to provincial government benefits. Where this is the case, leaving the home to the child might be considered, although this would generally not be appropriate if the child was not sufficiently

competent to be a homeowner. In other provinces, having the child with special needs own a home could affect the child's entitlement to social assistance benefits.

An option that could be considered would be to leave the home as part of the child's discretionary testamentary trust. In this case, it is generally advisable to include specific provisions in the will allowing the trustee(s) of the child's trust to use funds from the trust to pay for the upkeep of the home. It would also be advisable to allow the trustee(s) to sell the home and to use the proceeds to acquire a substitute home for the child, if considered to be in the child's best interests. A parent considering having the home held in trust for a child should also keep in mind the rules relating to the principal residence exemption (that is, an exemption that eliminates the capital gain on the disposition of a principal residence). Generally, a trust is not able to utilize this exemption unless it qualifies as a QDT or it was established for the benefit of certain minors.

Use of life insurance

Life insurance can be an effective way to ensure that there are sufficient funds to provide for a child with special needs on the death of the parent(s).

Because an outright payment of life insurance proceeds to a child with special needs may not be manageable by the child, and would invariably reduce or terminate social assistance benefits, it is generally advisable to have the life insurance proceeds held in a fully discretionary trust. The trust could be the same trust used to hold the other estate assets established under the will or it could be a separate insurance trust.

A separate insurance trust can be created in several ways, including:

- An insurance beneficiary designation in the will. This would direct that the insurance proceeds are to be paid to the executors as trustees of the insurance trust, who are to hold the funds in trust for the benefit of the child with special needs. . Since the trustees would be holding the proceeds in a separate role as trustees of the insurance trust, and not as executors of the estate, probate fees should not have to be paid on the amount of the insurance proceeds.

  Since an insurance designation in a will is generally only effective for policies in effect at the time the will is signed, it is advisable to include the specific policy number in the designation in the will, to ensure it will be effective from the insurer's perspective. The insurer should also be notified of the beneficiary change and should be provided with copies of the relevant portions of the will.

- The terms of the separate insurance trust could be set out in a separate document (rather than in the will). In this case, the beneficiary designation in the insurance policy would direct the proceeds to be paid to an insurance trustee, who would be obliged (by way of agreement) to settle the proceeds in a trust for the child with special needs.

  The use of a document separate from the will may offer better protection from creditors of the estate and from probate fees, as it would be clearer that the proceeds are not part of the estate.

Note that professional advice must be obtained as to the wording of the beneficiary designation and the creation of the trust, to ensure that the designation is valid and the trust meets the definition of a testamentary trust.

If an insurance trust is going to be used in addition to a separate testamentary trust for the portion of the estate that is to be left for the benefit of the child with special needs, care should be taken to ensure that the planning for the child is properly coordinated between the trustees of the two trusts. This is especially relevant if one or both of the trusts could qualify as a QDT since there can be only one QDT per electing beneficiary, as discussed above.

Support of dependants

When a parent is making provisions for a child with special needs to take effect on the death of the parent, it is important to keep in mind that each province has legislation that is designed to ensure that adequate provision has been made for individuals who are considered to be dependents. In most provinces (except British Columbia), some level of financial need or dependence on the parent must be demonstrated in order for a claim for support to be successful against a parent's estate.

This should be carefully considered when allocating the estate among intended beneficiaries.

Registered retirement plans

Some important decisions need to be made regarding the registered retirement plans (such as RRSPs, RRIFs, etc.) of the parent(s) to ensure that the plan proceeds are dealt with in the most effective manner on the death of a parent of a child with special needs. There are several options, which are outlined below:

Tax-deferred transfer to registered retirement plan for financially dependent child with special needs

The income tax rules allow for a tax deferral when registered retirement plan proceeds are transferred to a registered retirement plan for a child (or grandchild) who is financially dependent on the parent (or grandparent) for support by reason of mental or physical infirmity. (This is the language used in the *Income Tax Act* for mental or physical disability.)

The Canada Revenue Agency has indicated that the issue of whether an individual's child (or grandchild) is financially dependent on the individual for the purposes of this tax deferral is a question of fact to be determined in each case. In general, unless the contrary is established, it is presumed that an individual's child or grandchild is not financially dependent on the individual for support immediately before the individual's death if the child's (or grandchild's) income for the year prior to the year of the parent's (or grandparent's) death exceeds the basic personal amount.

Note that even if the income threshold is exceeded, it may still be possible to establish financial dependence based on factors such as the cost of living (including the cost of any medical or special care for the child paid for by the parent), the ability of the child to be financially self-

supporting, as well as the level of financial support provided by others. Financial dependence may also be established if it can be substantiated that the parent was required to provide financial support to the child because the costs of the child's special needs are greater than the child's own income.

To take advantage of this tax deferral, the parents could designate the child with special needs directly as the beneficiary of the registered retirement plans once both parents have died. The child would have to include the plan proceeds in his or her income for tax purposes, but if the child used the proceeds to acquire a registered retirement plan in the child's name, the child would get a tax deduction for that amount. Assuming all the qualifying conditions were met, the tax deferral would apply so no taxes would be payable.

However, a concern that often arises with this option is that it gives the child complete control over the transferred registered plan proceeds, which is often not desirable in the case of a child with special needs due to a mental disability. Accordingly, this option may be considered only if, after the death of the surviving parent, there will be a guardian or other person who will be legally responsible to manage the child's assets and financial affairs and who will have legal control over the assets. This would allow the tax-deferred transfer to be achieved without concern about the child's ability to manage the inheritance.

Note, however, that this option may make the child ineligible for social assistance benefits, since the child would be the owner of the registered plan proceeds.

Tax-deferred transfer to a registered disability savings plan for financially dependent child with special needs

The income tax rules also allow a tax deferral when registered retirement plan proceeds are transferred to a registered disability savings plan for a dependent beneficiary. The same considerations discussed under the transfer to a registered retirement plan for a child with special needs apply to this type of transfer as well.

This deferral will only apply to the extent the child has contribution room in his or her registered disability savings plan. The maximum lifetime contribution room per beneficiary for a registered disability savings plan is $200,000.

Tax-deferred transfer to an annuity for financially dependent child with special needs

The income tax rules also allow for a tax-deferred transfer of registered retirement plan proceeds which are used to acquire an annuity for an adult child (or grandchild) who is financially dependent on the parent (or grandparent) for support by reason of mental or physical infirmity.

This could be accomplished by naming the estate as the beneficiary of the registered plan proceeds after the death of the surviving parent, and then having the deceased parent's will leave the registered plans to the child with special needs. If the child was in fact financially dependent on the deceased parent by reason of disability (as defined under the *Income Tax Act*), the executor could then designate a qualifying amount as a refund of premiums (or a designated benefit if the plan is a RRIF). Under the tax rules, this amount would be considered to have been

received by the child in the year the amount was paid. The will could further require the executor to use the registered plan proceeds to acquire an annuity for the benefit of the child with special needs that meets the requirements of the *Income Tax Act*.

Assuming the child qualifies for the tax-deferred transfer allowed under the *Income Tax Act*, the use of an annuity for registered plans enables the parents to provide some protection for the interests of the child while also reducing the amount of tax payable on the death of the surviving parent.

It should be noted, however, that with this option, the child with special needs would receive outright payments of income from the annuity, so the child would still have some degree of control over money, which may be a concern. This income could also affect the child's continuing entitlement to social assistance benefits.

Tax-deferred transfer to an annuity for a lifetime benefit trust

A trust for a child that has special needs due to a mental disability, defined as a lifetime benefit trust under the *Income Tax Act*, could be named to receive the payments under the annuity, rather than having the payments made directly to the child (as discussed under the previous section). As referenced above, a lifetime benefit trust is not available for a person who has special needs because of a physical disability and the terms of the trust must provide that the child is the sole person beneficially interested in amounts payable to the trust under the annuity during the child's lifetime.

The use of a trust in this way, in conjunction with an annuity, would allow for a tax-deferred transfer of the registered retirement plans, and would also address the concerns noted above regarding the protection of the registered retirement plan proceeds if the child were to have full control over the annuity payments.

There is no specific requirement for the income and/or capital of the trust to be paid to the child with special needs. Accordingly, as long as the other requirements for the trust are met as set out above, it appears that it may be possible for the trust to be established as a fully discretionary trust. As described earlier, this would provide the trustees of the trust complete flexibility with respect to payments of income or capital to the child. Used effectively, this could help to protect the child's entitlement to social assistance benefits, depending on the rules applicable in the province or territory in which the child resides.

As noted above, there can only be one QDT per beneficiary with special needs. As a result, if a trust is established for the benefit of a beneficiary with special needs under a will and/or by virtue of an insurance designation and a separate lifetime benefit trust is established for some or all of that child's parents' (or grandparents') registered retirement plans, only one trust can qualify as a QDT and benefit from the graduated tax rates.

Transfer of after-tax proceeds of registered retirement plans to discretionary testamentary trust

If a tax deferral is not available or is not of concern or for ease of tax planning, the parent(s) could forego the tax-deferral options noted above and instead allow the registered plan proceeds to be taxed in the estate of the last surviving parent. The will could then provide that the after-tax proceeds of the registered plans are to form part of the estate of the surviving parent, with some or all of the proceeds to be held in a fully discretionary testamentary trust for the child with special needs, as described above. While there would be no tax deferral with this option, the control and protection offered by the testamentary trust would be available. Also, subject to the eligibility rules for social assistance in the province or territory in which the child resides, the trustees of the trust may also be able to make decisions about distributions of income and capital in a way that minimizes the impact on social assistance benefits.

This strategy may be particularly relevant for a child who is physically disabled, since the lifetime benefit trust is only available for a mentally infirm child.

CHOOSING TRUSTEES OF A TRUST FOR A BENEFICIARY WITH SPECIAL NEEDS

The trustees of a trust for a child with special needs, whether a lifetime trust or a testamentary trust, have many duties and responsibilities, including investing the trust assets, making decisions regarding distributions of income and/or capital, maintaining proper records, and ensuring that tax returns and tax elections are filed. As these obligations continue for as long as the beneficiary is alive, any proposed trustee must be willing and able to act and must understand that this commitment could continue for many years. In addition, given the nature and duration of the trustee's responsibilities, there are numerous additional considerations that should be taken into account in selecting appropriate trustees. For example:

- Age - Ideally, the trustees should be close in age to the beneficiary, or younger, since the trust may be in effect for many years. However, the original trustee could be older as long as the trust provides for one or more replacement trustees that are close in age to the beneficiary or younger.

- Place of residence - The trustees of a trust for a child with special needs should be familiar with the child and with his or her particular needs and circumstances. As these needs and circumstances may change over the years, it would be preferable if the trustees lived in relatively close proximity to the child, such as in the same city or province. This would be particularly important if there is an expectation that the trustees would be actively involved with the child. In addition, a trust resides where its central management and control is effectively exercised. If the trust is considered to reside outside of Canada for tax purposes, this may result in adverse tax consequences, such as the trust not qualifying as a QDT.

- Potential conflict of interest - Care should be taken to minimize any potential conflict of interest. For example, appointing one or more siblings of the child with special needs may appear to be a logical choice, but this could give rise to a possible conflict of interest

concern if the siblings are also named as the ultimate beneficiaries of the trust once the child with special needs has died. In this case, the siblings, if given broad discretionary powers, may put their own interests ahead of those of the child with special needs, and could, for example, decline to make payments out of the trust for the beneficiary with special needs, since such payments would reduce their ultimate inheritance.

- Skills and knowledge - The trustees must have sufficient knowledge and ability to be able to handle all of the duties expected. If there is a desire to protect a child's entitlement to government social assistance benefits, it would be particularly important for the trustees to be familiar with the applicable provincial rules.

- Attribution rules - In the case of a lifetime trust, the settlor could be named as a trustee of the trust, if appropriate, but should not be the sole trustee, to avoid the possible application of certain income tax attribution rules.

In many cases, naming two or more co-trustees to act together provides a satisfactory solution. If appropriate, one of the co-trustees might be an unrelated person, or a trust company, who can provide professional expertise to ensure that the administration of the trust is properly handled. The other co-trustee(s) could be one or more family members, who can provide a more personal perspective. In some cases, family members may be given only advisory or supervisory roles. Note that if there will be co-trustees, it would be important to ensure that there is a decision-making mechanism included in the trust document to resolve possible differences of opinion that could arise.

The trust document should also address the appointment of replacement trustees in case any of the initial trustees die or are otherwise not willing or able to act or to continue to act. It may also be appropriate to disqualify a trustee if he or she is or becomes a non-resident of Canada as this will help to ensure that the trust maintains its Canadian residency.

THE PREFERRED BENEFICIARY ELECTION

Under the *Income Tax Act,* a trust and a preferred beneficiary of that trust can jointly elect to have income from the trust taxed as income of the preferred beneficiary, rather than in the trust, even if the income actually remains in the trust. This provides considerable flexibility and can result in tax savings. For the purposes of this election, a preferred beneficiary is a beneficiary of a trust who meets the following criteria:

- The beneficiary must be an individual who is resident in Canada.

- The beneficiary must be entitled to claim the disability tax credit (for mental or physical impairment), or must be an adult who was dependent on another individual because of mental or physical infirmity and whose income does not exceed the basic personal amount.

- The beneficiary must be the person who established the trust (that is, the settlor, as noted earlier), or the settlor's current or former spouse or common-law partner, or the child, grandchild or great-grandchild of the settlor (or of the settlor's spouse or common-law partner).

Note that the relationship between the beneficiary and the settlor of the trust is vital to the preferred beneficiary election. It is therefore important to ensure that the settlor's status remains intact. Problems could arise, for example, if a person other than the settlor contributes additional property to the trust if the trust is a lifetime trust. This could cause the settlor to lose his or her status, with the result that the beneficiary could cease to be considered a preferred beneficiary of the trust, even though the trust is not changed.

It is also important to consider whether using the preferred beneficiary election could have an effect on the beneficiary's eligibility for social assistance benefits. In particular, the beneficiary's income tax return, which may have to be produced each year to enable the social assistance agency to verify the beneficiary's income, would reflect trust income that had been allocated to the beneficiary in the year. This could result in the beneficiary's entitlement to benefits being reduced or even terminated, even though the funds in many cases may not actually have been paid to or for the benefit of the beneficiary.

Conclusion

The foregoing discussion highlights some of the key areas and planning opportunities involved in providing for the long-term financial security of a person with special needs. Because this is a very complex area that is constantly evolving, consultations with professional legal and tax advisors who are knowledgeable in this area are recommended in order to ensure that the most effective plan is put in place for the benefit of the person with special needs.