The Use of Trusts in Estate Planning & the RDSP

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THE USE OF TRUSTS IN ESTATE PLANNING & THE RDSP

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I. Introduction

This paper deals with two topics: the use of trusts in estate planning and the registered disability savings plan. With respect to trusts, we will first discuss inter vivos trusts, then move on to testamentary trusts. Situations where each trust can be used will be described, and the tax treatment of the trusts will also be examined. We will end the paper with a discussion of the registered disability savings plan and how it operates for the beneficiary of such a plan.

II. Inter Vivos Trusts

A. What is an Inter Vivos Trust?

For the purposes of this paper, we do not intend to go into any depth in regards to the settlement or requirements of a trust. Suffice it to say that, in order for a trust to be properly constituted, there must be three certainties: (a) certainty of intention; (b) certainty of subject matter; and (c) certainty of objects. At trust law, regardless of the type of trust, all require these three certainties in order to exist.

The distinction between inter vivos and other types of trusts is relevant when it comes to tax law. Pursuant to the Income Tax Act (Canada) (the “Act”), there are a number of different types of trusts. In this paper, we generally focus on two types of trusts, one being inter vivos and the other being testamentary. Inter vivos trusts are trusts settled during the lifetime of the settlor. Testamentary trusts, on the other hand, arise “on and as a consequence of the death of an individual”.4

B. Where can an Inter Vivos Trust be used?

Inter vivos trusts can be used in a number of situations ranging from estate freezes (commonly used in estate planning) to circumstances where property should be placed in trust for the protection of beneficiaries. These different circumstances will be examined in more detail.

(a) Estate Freezes

An estate freeze is a tax planning mechanism whereby the shareholders of a company exchange their common shares for preferred shares of the same company. Those preferred shares would have a value equal to the fair market value of the common shares so exchanged. Because the value of the preferred shares does not move up as the company becomes more valuable, those shareholders who own only preferred shares in the company have the value of their estate (as it relates to those shares) “frozen”.

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1 For those persons who are interested in reading about Canadian trust law, we recommend Donovan W.M. Waters, Q.C., Mark R. Gillen & Lionel D. Smith, Waters' Law of Trusts in Canada, 4th ed (Toronto: Carswell, 2012).
2 Knight v. Knight (1840), 3 Beav. 148; 49 ER 58 (Ch.) is the most-cited case for this proposition.
4 Ibid., s. 108(1), definition of “testamentary trust”.
Consider a situation where a married couple, Joe and Katey (each 59 years old), have been referred to you for legal planning and advice. Joe and Katey have three children – Dustin (age 29), Darcie (age 26) and Allie (age 17). Joe and Katey own all of the issued and outstanding shares of a construction company, which has done very well. Dustin has worked for the company since he graduated from high school. Darcie suffers from a disability and qualifies for the federal disability tax credit certificate. Allie will be starting university in the next year or so. Joe and Katey currently provide financial assistance to Darcie and Allie, and expect to do so for the foreseeable future. All of these persons are citizens and residents of Canada, and are not citizens or residents of any other country. In your meeting with Joe and Katey, they have expressed a number of objectives, including:

(a) They are looking at retirement and are seeking out a way to smoothly transfer the company to Dustin;
(b) They are interested in providing financial assistance to Darcie and Allie in a tax efficient manner; and
(c) They would like to minimize the amount of income tax that their estates will incur upon their deaths.

Before embarking upon a plan, an identification of a few income tax rules will be helpful:

(a) Individuals who are resident in Canada are subject to graduated income tax rates. The higher one’s income, the higher the tax rate. In Saskatchewan, different income tax rates apply to ordinary income, dividends (eligible and non-eligible), and capital gains. On ordinary income, the rates range between 0%-44%; on eligible dividend income, the rates range between 0%-24.81%; on non-eligible dividend income, the rates range between 0%-34.91%; and on capital gains, the rates range between 0% - 22%. That being the case, to the extent that income can be split (or sprinkled) amongst various family members, generally speaking less income tax will be paid; and
(b) Upon the death of an individual, the general rule is that the individual is deemed to have disposed of all of his or her capital property at its fair market value immediately before death. A significant exception to this rule arises where the property is left to a surviving spouse or common-law partner who is resident in Canada immediately before the taxpayer’s death, or to a trust created by the taxpayer’s Will for the benefit of that spouse (the “survivor”). In those circumstances, provided that the property “vests indefeasibly” in the hands of the survivor within 36 months of the death of the taxpayer, the property will transfer to such beneficiary at its tax cost. This is typically referred to as a “spousal rollover”. As a practical matter, in many cases when

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5 A discussion of the requirements to be met for the federal disability tax credit certificate will be discussed in the section dealing with registered disability savings plans below.
6 Act, supra note 3, s. 70(5).
7 For the purposes of this paper, any reference to spouse will mean a reference to spouse or common-law partner.
8 Act, supra note 3, s. 70(6).
9 Ibid.
dealing with estate planning for a married couple, most of the adverse income tax consequences arise upon the last of them to die because, for the most part, there is no tax rollover available when property is left to children.\(^\text{10}\) To the extent that the property held by the survivor has minimal capital gains, less income tax will be paid.

One plan that may be of assistance in meeting the objectives which have been set out by Joe and Katey is as follows:

(a) Determine the fair market value of all issued and outstanding shares of the construction company;
(b) Ensure that the authorized share capital of the construction company includes non-voting common shares, voting preferred shares (which have a minimal subscription price), and non-voting preferred shares (which are redeemable by the corporation and retractable by the shareholder, with a limited dividend entitlement);
(c) Have a friend or other relative of Joe and Katey settle a trust.\(^\text{11}\) The trust can be settled with a gold coin or, alternatively, it could be settled with cash (e.g. two $20.00 bills). Joe and Katey will be the trustees. The beneficiaries of the trust will consist of Joe and Katey, their children (Dustin, Darcie, and Allie), any future grandchildren, and any corporation incorporated in Canada which is controlled by the trust or any of its beneficiaries. The trust will be a discretionary trust, which means that the trustees may distribute income or capital of the trust amongst all or any of the beneficiaries as they decide from time to time;
(d) Joe and Katey will exchange all of their existing shares in the capital stock of the construction company for 1,000 voting preferred shares (having a value of $10.00), and 10,000 non-voting preferred shares (redeemable and retractable) having a value equal to all of the shares exchanged by Joe and Katey, less the sum of $10.00. This transaction proceeds on a tax rollover basis under either s. 86 or s. 51 of the Act. The result of this share exchange is that the shares held by Joe and Katey have a fixed value. Their estates, as they relate to this particular property, are now “frozen” in value (subject to future reductions should any of these shares be redeemed or repurchased by the construction company);
(e) The inter vivos trust will subscribe for 20 non-voting common shares for the sum of $20.00 (using one of the $20.00 bills that was provided as part of the settled property);

\(^\text{10}\) While the authors recognize that there can be tax rollovers of qualified farm property, qualified fishing property and, in very limited circumstances, RRSPs, these are limited exceptions to the general proposition that accrued gains on wealth are taxed when wealth is transferred from parents to children.

\(^\text{11}\) It is important that the settlor of the trust is someone who is not, and will not be, a trustee or beneficiary of the trust. If any trust property can be seen to be reverting back to the person who provided such property to the trust, s. 75(2) of the Act will apply and any income earned on the trust property will be attributed back to the settlor and not to the trust. This creates a situation where the tax benefits of using a trust are no longer available. Further, if s. 75(2) of the Act applies, the trust loses its ability to rollover its property to its beneficiaries on a tax-free basis. This rollover is discussed later in this paper.
(f) In the future, the construction company can declare and pay dividends on the common shares held by the trust. The trust, in turn, can take those dividends and pay them out to all or any of the beneficiaries. This will provide a source of income to those beneficiaries. One caution to note is that no dividends should be paid out to Allie until she is 18 years of age or older, or else the kiddie tax will apply. The kiddie tax is, effectively, a penalty which imposes the highest marginal tax rate on certain types of income earned by an individual who is under the age of 18 years; and

(g) As part of the estate plan, in due course, the shares of the construction company are to be transferred to Dustin. In this regard, the structure that has now been put in place may be eligible for a number of preferential tax rules. The first rule to keep in mind is that if the trust has been properly settled, the trustees can ultimately distribute the corpus of the trust to any Canadian resident beneficiary on a tax rollover basis. As such, the common shares held by the trust in the construction company can be transferred out to Dustin on a tax rollover basis. The second rule to keep in mind is that if the shares held by Joe and Katey are “qualified small business corporation shares”, Joe and Katey can transfer those shares to Dustin. While the transfer of the shares is deemed to proceed at fair market value, any resulting capital gains may be able to be sheltered from income tax by the capital gains exemption. The present capital gains exemption is $800,000.00. After 2014, the amount of the exemption is indexed in accordance with the Consumer Price Index.

(b) Protection of Beneficiaries

Inter vivos trusts can also be used to protect beneficiaries, whether that protection is from themselves or from others. The three situations below are all quite similar in that we are dealing with beneficiaries who are, for whatever reason, unable to properly (in the view of whomever is setting up the trust) manage property, thereby necessitating the need for planning involving trusts.

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12 Act, supra note 3, s. 120.4.
13 Ibid., s. 107(2).
14 The definition of “qualified small business corporation share” is set out in subsection 110.6(1) of the Act. It is beyond the scope of this paper to describe in detail all of the requirements and conditions that must be satisfied in order to meet the terms of this definition. Suffice it to say that a taxpayer will own qualified small business corporation (“QSBC”) shares in circumstances where (a) all or substantially all (generally interpreted by Canada Revenue Agency to mean 90% or more) of the fair market value of the assets of the particular corporation are used in an active business carried on in Canada, (b) for at least 24 months prior to the disposition of any such share, at least 50% of the fair market value of the assets of the particular corporation are used in an active business carried on in Canada, and (c) for at least 24 months prior to the disposition of any such share, the share was not owned by anyone other than the particular individual or a person or partnership related to that individual. Additional rules also exist that allow for the shares of certain holding companies to meet the definition of a QSBC share.
15 Act, supra note 3, s. 69(1)(b).
16 Ibid., s. 110.6.
17 Ibid., s. 117.1.
i. Disabled Beneficiaries

Two situations will be considered here – one where the beneficiary needs protection from his or her own poor decisions that are brought about as a consequence of some form of disability, and the other where the beneficiary wants to maximize the amount of social assistance or asset-tested benefits that he or she can receive.

Remember Darcie from our example earlier? She is Joe and Katey’s middle child and she qualifies for the federal disability tax credit certificate. Let’s assume that Darcie does not have the mental capabilities to be able to competently deal with her own property, bank accounts or investments. In this case, an inter vivos trust can be a useful planning tool in that it allows for the disabled person to receive the benefits associated with the trust (whether by way of dividends that flow through the trust or the transfer of trust property) while, at the same time, ensuring that the beneficiary does not control or make decisions with respect to the trust property. In that case, the trustee (in our example, Joe and Katey) would make decisions as to when and how much property the beneficiary would receive from the trust, therefore protecting the beneficiary from potentially making some poor choices.

This ties in with the second situation where an inter vivos trust can be used to maximize social assistance benefits available to a disabled person. In Saskatchewan, the provincial government provides social assistance benefits to people with disabilities. The amount of those benefits is determined by taking into account the disabled person’s income and, sometimes, assets. With respect to social assistance benefits, the government has provided a policy statement that indicates that, if funds are held in trust for a disabled person who has applied for assistance and the disabled person has no control over the trust, the “[t]rust funds that are not available for distribution or funds provided for items not covered by assistance are not assessed in calculating entitlement”18 to those benefits. However, “[w]here payments are made from any trust fund for needs that assistance would cover, the payment is assessed as income.”19 More will be said about this later in this paper under the heading “Henson Trusts”.

ii. Minor Beneficiaries

Except in certain limited circumstances, contracts with minors are not enforceable. This means that, by and large, minors do not have the capacity at law to enter into contracts. Hence, a minor does not legally have capacity to deal with property if it is in his or her name outright. Additionally, minors are simply too young and lack the necessary

19 Ibid.
maturity to deal with large amounts of property in a thoughtful manner. No 15 year old is mature enough to handle $100,000.00.\footnote{We have no authority to cite for this proposition. This is just common sense.}

A minor can, however, be a beneficiary of a trust. As we indicated earlier, Allie (Joe and Katey’s 17 year old daughter) is one of the beneficiaries of the inter vivos family trust set up to own the common shares of the construction corporation. This trust can be used to provide benefits to Allie (if the terms of the trust require or if the discretion is given to the trustee to allow distributions to be made to or for the benefit of the particular beneficiary) while maintaining control of the trust with someone who would have the legal capacity (and hopefully maturity and thoughtfulness) to manage the trust’s property.

When meeting with Joe and Katey, we would want to discuss at what age Allie may be old enough and mature enough to manage the trust property. Perhaps payments of larger and larger amounts can be made throughout the time the trust is in place in order to provide an opportunity for Allie, once she reaches the age of majority, to “grow into” her inheritance. Perhaps a transition plan in terms of trusteeship should be put in place where Allie, upon reaching age 18 or 21 or whatever age the parents wish, becomes a co-trustee of the trust. Then, at an appropriate age of maturity, Allie can become the sole trustee and thereafter manage the property of the trust. Of course, these intentions will need to be written into the terms of the trust itself.

iii. Beneficiaries who need to be Saved from Themselves

Consider the situation where an individual (a parent, for example) would like to be able to help out another individual (an adult child, for example) who is either a spendthrift or has a substance addiction where the likelihood is that the child cannot properly manage property that would otherwise have been provided to him or her directly. If the parent simply provided the child with money, chances are that money will be spent very quickly on unnecessary or dangerous items. No parent wants to feed their child’s drug addiction. A trust can be used in that situation in order to, for the most part, protect the beneficiary from himself or herself. If the trust is set up such that the trustee, who will obviously not be the child with the problem, has the discretion to determine when payments are made out of the trust and the beneficiary does not have the right to require payments from the trust at any time, the trustee would be in the position of a protector of the child and can provide funds to the child when and if the protector thinks it is appropriate to do so. Such a trust can also be written such that payments out of the trust do not necessarily need to be in the form of money. Rather, the trustee could pay the rent, utilities, or other bills, or the trustee could buy food or other necessities for the beneficiary using the trust property.
C. How are Inter Vivos Trusts Taxed?

(a) Tax Rates

Under the Act, a reference to a trust or estate generally includes any reference to a “trustee, executor, administrator, liquidator of a succession, heir or other legal representative having ownership or control of trust property.” For the purposes of the Act, a trust is deemed to be an individual in respect of the trust property. For many years, the tax rates applicable to inter vivos trusts as compared to testamentary trusts were materially different. An inter vivos trust is generally taxed on all of its taxable income as if it was an individual subject to the highest marginal income tax rate, but without the benefit of personal tax credits. Historically, the tax rates applicable to the taxable income of a testamentary trust were far better, although in many respects this is going to be changing over the next few years. (Later in this article, we comment on the tax rates applicable to testamentary trusts and the pending changes.) Notwithstanding the rather harsh tax regime imposed on the taxable income retained within an inter vivos trust, several income tax advantages exist in connection with ownership structures that make use of trusts, including inter vivos trusts.

i. Distributing Income to Beneficiaries

Over the last several years, many legal and tax advisors have encouraged their clients to use trusts as part of their planning. Generally speaking, if properly settled, a trust can deduct all amounts paid or payable to its beneficiaries. This can create significant advantages as well as flexibility in income splitting. Consider the situation we discussed earlier with Joe and Katey. Joe and Katey’s trust was settled by a third party with two $20.00 bills. The trustees of the trust are Joe and Katey. The beneficiaries of the trust are Joe, Katey, their children, their grandchildren (present and future), and corporations controlled by the trust or any of the aforesaid beneficiaries. Some of the settled property (one of the $20.00 bills) is used by the trust to purchase all of common shares of the construction company (“Opco”), which shares are issued as part of an estate freeze reorganization. Opco declares and pays a dividend in the amount of $100,000.00 on the common shares held by the trust. Provided that the terms of the trust permit the trustees the discretion to allocate and pay income and capital to all or any of the beneficiaries in any proportion or amount as the trustees may determine from time to time, a considerable amount of flexibility now exists:

(a) The $100,000.00 dividend received by the trust must be recognized as income. However, provided that Joe and Katey pay over such income to the beneficiaries (all or any of them) by December 31 of the

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21 Act, supra note 3, s. 104(1).
22 Ibid., s. 104(2).
23 Ibid., s. 122(1).
24 Ibid., s. 104(6)(b)(i).
calendar year in which the dividend has been received, such payment to the beneficiaries becomes a tax deduction to the trust. The net result to the trust is that it will have no income at the end of the year which will be subject to tax;

(b) Generally speaking, when a trust pays out its income to its beneficiaries, that income retains its same character in the hands of the beneficiaries. For example, dividend income allocated by a trust to a beneficiary is still considered dividend income in the hands of the beneficiary.\(^{25}\) The same holds true for taxable capital gains paid and allocated by a trust to its beneficiaries;\(^{26}\) and

(c) In our example, the $100,000.00 of dividend income could be allocated to any of Joe, Katey, Dustin, Darcie, Allie (once she is 18 years of age or older) or any corporation controlled by any of them. Essentially this allows for the dividend income to be distributed amongst family members (or controlled corporations) in a tax efficient manner.

In the example noted above, you will see that we have recommended income distributions out of the trust to beneficiaries who are at least 18 years of age. If a particular beneficiary is under the age of 18 years, in most circumstances there would be little tax advantage to the trust paying over dividend income to such child. The reason for this is because in the hands of that minor child, the dividend income would be taxed at the highest marginal income tax rate as a result of the “kiddie tax” rules.\(^{27}\)

The inclusion of controlled corporations as beneficiaries of Joe and Katey’s discretionary family trust has several advantages. In the context of our example where the trust has received $100,000.00 of dividend income, as long as Joe and Katey control Opco and also control the corporation which is the beneficiary of the trust (the “Holdco”), the trust could allocate the $100,000.00 dividend (or any portion thereof) to Holdco. Holdco could receive the dividend from the trust without incurring any income tax liability.\(^{28}\)

ii. Multiplying Access to the Capital Gains Exemption

As noted earlier in this paper, the trustees of a trust can distribute and pay trust income to one or more beneficiaries of a discretionary family trust. When the income of a family trust includes taxable capital gains, not only can the taxable capital gains be distributed and retain their same character

\(^{25}\) Ibid., s. 104(19).

\(^{26}\) Generally see Ibid., s. 104(21)-(21.3).

\(^{27}\) Ibid., s. 120.4.

\(^{28}\) Generally speaking, dividends received by a taxable Canadian corporation are deductible under subsection 112(1) of the Act in determining their taxable income for the purposes of Part I of the Act. Furthermore, no Part IV tax will apply where the payor and payee companies are connected. For an additional explanation on the tax rules that are applicable to this type of structure, see Kim G.C. Moody, “Recent Issues in Owner-Manager Remuneration Planning”, 2004 Conference Report (Toronto: Canadian Tax Foundation, 2004), in the section of the article discussing “The ‘Triangle’ Structure.”
in the hands of beneficiaries, those taxable capital gains also retain that same character in the hands of Canadian resident beneficiaries where the taxable capital gains arise from the disposition of qualified farm property or qualified small business corporation shares.\textsuperscript{29} The advantage of this is that, in the hands of a Canadian resident individual who otherwise has unused capital gains exemption, the allocation of these taxable capital gains is eligible to be included in his or her tax return with an off-setting deduction of the capital gains exemption under section 110.6.

The use of the discretionary family trust in these circumstances can be very advantageous. Going back to the example with Joe and Katey, if Joe and Katey owned all of the shares of the construction company (a small business corporation) personally and if a taxable capital gain is realized on the shares of the company, we would only be able to access each of Joe and Katey’s capital gain exemption to decrease their taxes payable. However, if a discretionary family trust holds the shares of the small business corporation and realizes a taxable capital gain, that taxable capital gain can then be allocated and paid out to all of its individual beneficiaries who are residents of Canada. This can include children and grandchildren if they are beneficiaries of the trust. Typically if the trust has been structured properly, one need not worry about attribution of the taxable capital gains.\textsuperscript{30} Furthermore, where the taxable capital gain is realized on the disposition of qualified small business corporation shares to a person who deals at arm’s length to the minor child, the “kiddie tax” will not apply.\textsuperscript{31}

(b) \textbf{Tax Trap – Association of Companies}

One of the potential disadvantages of a family trust arises because of the association rules under the Act. Typically where corporations are under common control, they are considered to be associated. When corporations are associated, certain adverse tax consequences arise, including the requirement to share the benefit of the $500,000.00 small business deduction.\textsuperscript{32} In 2014, a Saskatchewan company earning income from an active business in Canada is entitled to an income tax rate of 13\% on its first $500,000.00 of Canadian active business income, assuming the company has full entitlement to the small business deduction. Any business income earned which is not eligible for the small business deduction is subject to a tax rate of 27\%. If that corporation is associated

\textsuperscript{29} \textit{Act, supra} note 3, s. 104(21.2), (21.21), and (21.22).
\textsuperscript{30} \textit{Ibid.}, s. 74.1(2). While the attribution rules generally apply to attribute income or loss from property (or substituted property) where an individual has transferred or loaned property (whether by means of a trust or otherwise) to or for the benefit of a person who is under 18 years of age, the attribution rules in relation to minors do not extend to taxable capital gains or allowable capital losses.
\textsuperscript{31} \textit{Ibid.}, s. 120.4(4) & (5). Be careful, however, where QSBC shares are disposed of to a person who does not deal at arm’s length with the minor child. In these circumstances, the kiddie tax applies to the capital gains subject to dividend tax rates instead of capital gains tax rates.
\textsuperscript{32} \textit{Ibid.}, s. 125(1).
with one or more corporations, they must share the entitlement to the lower tax rate on their combined Canadian active business income of $500,000.00.

The concept of control for the purposes of the association rule is extremely broad. Where a discretionary family trust owns all of the common shares of a corporation (“Opco”), the trust itself is deemed to control that corporation simply because it owns more than 50% of the issued and outstanding common shares in that body corporate. Each beneficiary of the discretionary family trust is, in turn, deemed to be in a control position with respect to that corporation. The result is that if any of the beneficiaries of the trust should, for example, establish their own corporations in the future, those corporations will be associated with the Opco simply because the beneficiary happens to be a beneficiary of the trust which owns all (or at least a majority) of the issued common shares in the capital stock of Opco. This can be a trap for the unwary.

(c) 21 Year Rule and Trust Wind-Ups

One thing to keep in mind in connection with trusts is that with very few exceptions, on the 21st anniversary of the trust, it is deemed to dispose of all of its capital property or land included in the inventory of the business of the trust for proceeds equal to the fair market value of such property. There are some exceptions to this rule, the most important of which are:

(a) Spousal Trusts where the deemed disposition is on the date of death of the spouse;
(b) Joint Partner Trusts where the deemed disposition is on the date of death of the survivor of the settlor and spouse; and
(c) Alter Ego Trusts where, unless a contrary election is made, the deemed disposition occurs on the date of the settlor.

For most discretionary family trusts, its principal property will often consist of common shares of private corporations. These shares will usually increase in value over the life of the trust. The accrued capital gain on these shares will be taxed on the 21st anniversary of the trust unless steps are taken to avoid the pending deemed disposition.

A transfer of property from one trust to another trust does not avoid (or reset) the 21 year period. If a capital gain or other income is realized on the 21st anniversary of the trust because of the deemed disposition rule, income tax will have to be paid. It is possible to elect to pay the tax in up to 10 annual installments subject to posting security and paying interest. However, often the preferred planning is to avoid the deemed disposition. While there are a number

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33 Ibid., s. 256(1.2)(c)(ii).
34 Ibid., s. 256(1.2)(f)(ii).
35 Ibid., s. 104(4). Similar rules apply in s. 104(5) and (5.2) to depreciable capital property and resource property.
36 Ibid., s. 104(4)(a) and (a.4).
37 Ibid., s. 104(5.8).
38 Ibid., s. 159(6.1) and (7).
of different planning alternatives, the most common planning tool is to distribute the property of the trust on a tax rollover basis to the Canadian resident capital beneficiaries of the trust. This tax deferral (or tax rollover) is permitted where the distribution is made to the Canadian resident beneficiary in satisfaction of a capital interest in a personal trust. Note that there is no rollover in satisfaction of an income interest in a trust. One also has to be very careful to ensure that section 75(2) has never applied to the trust. If it has, this can either restrict or entirely eliminate the ability to wind-up the trust in a tax-free manner. Section 75(2) can apply, for example, where the person who settles the trust ends up being the controlling trustee or otherwise has an interest in the property of the trust. Note that as a result of some recent judicial decisions, section 75(2) does not apply in a situation where a person sells property to a trust at fair market value.

Using our example with Joe and Katey, as their discretionary trust approaches its 21st anniversary, a plan will need to be put in place to distribute the trust property to the beneficiaries of the trust to avoid the tax payable on the deemed disposition. It may be that Dustin is running the business on his own, so he gets the shares. Maybe Allie has also joined the business, so she will get some shares too. A determination of who receives the shares will need to be made at that particular time, after consultation with advisors and upon consideration of the family’s circumstances then.

III. Testamentary Trusts

A. What is a Testamentary Trust?

For the purposes of the Act, a testamentary trust means a trust that “arose on and as a consequence of the death of an individual”. This includes a trust created under the terms of a taxpayer’s Will, or by an order of a court in relation to a taxpayer’s estate made under provincial law that provides relief or support of dependants. There are a number of situations where testamentary trusts can be established as part of an estate plan, including:

(a) A trust for a surviving spouse under a Will (sometimes, and herein, referred to as a “spousal trust”).
(b) A “successor trust” under a Will which is settled with property from a spousal trust following the death of the spouse. This can arise, for example, where one spouse dies leaving property in a spousal trust for the surviving spouse. Upon the death of the second spouse, that property is then transferred down into new trusts (being successor trusts) for children and their issue.

40 Act, supra note 3, s. 107(2).
41 Ibid., s. 107(4.1).
43 Act, supra note 3, s. 108(1), definition of “testamentary trust”.
44 Ibid., s. 248(9.1).
(c) Trusts funded from life insurance proceeds provided the individual establishes the terms of such trusts during his or her lifetime, whether within or outside of the Will.\textsuperscript{45}

Be careful not to do something that “taints” the trust and thereby disqualifies it as being a “testamentary trust” under the Act. This can occur, for example, where someone contributes property to the trust other than the individual who has passed away. It can also occur where the trust incurs a debt or obligation which is owed to or guaranteed by a beneficiary or some other person or partnership with whom the beneficiary does not deal at arm’s length, other than in certain narrow circumstances permitted under the Act.\textsuperscript{46}

B. Where can a Testamentary Trust be used?

(a) Trust for Spouses and Common-Law Partners

An individual can prepare a Will that provides that a trust be established upon death for the benefit of his or her surviving spouse. This type of spousal trust may be eligible for certain advantages, which will be discussed shortly below.

A spousal trust may also be set up in a situation where one spouse’s parents have accumulated a great deal of wealth which is to remain in the blood family line. Going back to Joe and Katey, let’s say that Katey’s parents had accumulated a great deal of wealth through real estate investments. They have a corporation that owns a number of commercial properties. Katey has shares in her parents’ corporation. Kate (and her parents) wish for Joe to have the benefit of income that is paid on the shares during his lifetime but, when he dies, the shares are to be passed to Katey’s children (thereby maintaining the company in the long term in the family blood line). Katey and her parents do not wish to allow for Joe to dispose of the shares in the family’s corporation such that they would not be available for Katey’s children upon Joe’s death. In this situation, a spousal trust governing Katey’s shares in her family’s real estate corporation can be written into the terms of Katey’s Will that will provide the desired results.

i. Tax Rollover

Recall that, at tax law, when a person dies, he or she is deemed to dispose of his capital property immediately before death at its fair market value.\textsuperscript{47} This means that the deceased person’s property would be valued as of the date of death, and the excess (if any) of the fair market value over the tax cost amount of such property would result in a gain which is taxable. There is a rollover that is available to the deceased’s estate where the property is left to a Canadian-resident spouse or a spousal trust for certain property of a deceased person. This allows such property to be transferred in these circumstances on a tax-free basis. If the Wills are set up such that, on the first of the spouses to die, everything goes to the surviving spouse outright, the benefit of this rollover would still be received by the estate

\textsuperscript{45}Canada Revenue Agency, Views 2009-0350811E5.

\textsuperscript{46}These circumstances are set out in subparagraphs (d)(i)-(iv) of the definition of “testamentary trust” in subsection 108(1) of the Act.

\textsuperscript{47}Act, supra note 3, s. 70(5).
(and surviving spouse). However, the same rollover can occur if capital assets are transferred to a spousal trust. The requirements that a trust must meet in order to be considered a spousal trust for tax purposes are set out in s. 70(6) of the Act. In order to be considered a spousal trust for the purposes of taking advantage of the rollover rules:

(a) The trust must be resident in Canada immediately after property vests indefeasibly in the trust;
(b) Under the terms of the trust, the taxpayer’s spouse is entitled to receive all of the income of the trust that arises before his or her death; and
(c) No person except a spouse may, before the spouse’s death, receive or otherwise obtain the use of any of the income or capital of the trust.

If the spousal trust does not meet the requirements of the Act immediately after the property vests indefeasibly in the trust, the rollover associated with the spousal trust will not be available.

Note that certain types of property are not eligible for the tax rollover if they are transferred to a spousal trust on death. Deferred income plans such as RRSPs and RRIFs can only pass on a tax-rollover basis to the surviving spouse, and not to the spousal trust.

(b) Trusts for Children

Just like the spousal trusts discussed above, a testator can provide for trusts for his children in his Will. In our firm’s practice, we typically have two different types of such trusts that we use – one that we call a short term trust and one that is long term.

The reference to short term trust is a bit of a misnomer. It doesn’t necessarily mean that the trust will only be in place for a short amount of time. Rather, it means that the trust will be in place for a certain pre-determined amount of time. These trusts are trusts to age 18, 21, 25 or any other age that the client chooses. We typically see these trusts put into place for individuals whose net worth isn’t particularly high and for whom the benefits of a long term trust would not be worth the cost of putting such a trust in place.

Long term trusts are, however, just that – trusts that are designed to continue to operate (should the trustee determine that is appropriate) for an indefinite period of time (or at least until such time as the property of the trust may be deemed to have been disposed of as a result of the operation of certain provisions under the Act[^48]). These trusts can be set up so that the child of the testator, along with such child’s issue, are the beneficiaries of the trust. The parent chooses who the trustee will be. The child, if old enough and if the parent thinks appropriate, can be the trustee. These trusts are typically discretionary trusts where the trustee decides how much of the income or the property of the trust is made available to any

[^48]: Referring to the 21-year rule discussed elsewhere in this paper.
beneficiary from time to time. The trustee can determine when the trust is to be wound up (if at all) and to whom the property would be distributed. The trust can also provide for what occurs with the trust property if there should come a time that there are no beneficiaries of the trust left. Going back to Joe and Katey once again, each of them could set up these types of long term trusts for each of Dustin and Allie.

Why would someone want to use a long term trust for a child? There are a couple of different reasons. First, remember that a trustee can decide whether income earned by trust property is taxed within the trust itself or whether such income is “flowed” down to the beneficiaries to be taxed in their hands. Further, as you will see below, testamentary trusts (for the most part) will be taxed at the highest marginal rate starting in 2016. If a beneficiary of a trust requires funds from the trust and that beneficiary’s tax rate is lower than the top marginal rate, having the income flow down to such beneficiary will result in a tax savings equal to the difference between the two tax rates. The same is true as between beneficiaries.

Let’s use the long term trust for Dustin as an example. Dustin’s income is such that he is taxed on it at the top marginal rate. Dustin is the trustee of the long term trust. He has a child who is 18 years old and does not earn income. This child attends university and requires assistance with tuition, books, etc. Trust funds could be used in a tax-efficient manner to get the child the support she needs. Rather than having Dustin take income out of the trust only to have it taxed at his top marginal rate, the income could be paid directly to his child as a beneficiary of the trust to have it taxed at her marginal rate. From an income splitting perspective, to the extent that income can be paid over and taxed in the hands of a beneficiary who is subject to low tax rates (or is not taxable at all), significant tax savings can be achieved.

(c) Trusts for Persons Under a Disability

When discussing trusts for people with disabilities, the most common type of trust that is discussed is the Henson Trust, which has its roots in the decision of the Supreme Court of Ontario in *Ministry of Community and Social Services, Income Maintenance Branch* v. *Henson*. In that case, Mr. Henson passed away, having made a Will in which he provided that funds were to be placed in a trust for the benefit of his handicapped daughter, Audry. Mr. Henson named 3 trustees of the trust and provided that they had “absolute and unfettered discretion” as to when to pay out any income or capital of the trust to Audry. Further, the Will provided that, upon Audry’s death, the trustees were to transfer the remainder of the estate to the Guelph District Association for the Mentally Retarded.

The value of Mr. Henson’s estate that was to be placed in trust was approximately $82,000.00. Audry was receiving provincial assistance benefits at the time, and

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50 Ibid.
51 Ibid.
the Director of the Income Maintenance Branch of the Ministry of Community and Social Services had cancelled the allowance payments on the basis that, because of the funds in the trust, she had “liquid assets” exceeding $3,000.00 (which was the threshold for assistance pursuant to the relevant legislation at the time). After the Director made his decision, an appeal to the Social Assistance Review Board was made which reversed the Director’s decision to deny Audry’s benefits. The Director appealed the Review Board’s decision to the Supreme Court of Ontario – Divisional Court. Callaghan A.C.J.H.C. determined that, because the trustees had absolute and unfettered discretion and because Audry could not require the trustees to make payments to her, she did not have a “beneficial interest in assets held in trust and available to be used for maintenance”, which was the requirement under the relevant regulations to be met. Callaghan A.C.J.H.C.’s decision was appealed by the Director to the Ontario Court of Appeal, who dismissed the appeal and agreed with the decision of the Divisional Court.

Henson Trusts are now commonly used to allow parents of special needs children to provide a benefit to such children without interfering with social assistance funding to which such children are otherwise entitled. The Saskatchewan government has specifically dealt with money held in trust in its policies regarding social assistance payments. It has said the following:

20.1.6 Money held in Trust

A trust fund refers to funds belonging to the trust. A trust is an obligation binding trustees to deal with property (which can be liquid, real, personal) over which they have control for the benefit of others (which may include the trustee and other beneficiaries). The client has no control over the trust.

Trusts are held by some other person, agency or community group on behalf of the client, his/her spouse, or dependant children.

A copy of the will or documentation from the trustee is provided to confirm the trust and its conditions.

Trustees do not have ownership of trust funds in terms of being able to deal with those funds as if they were their own assets, but are bound by the conditions of the trust and the law on trusts to deal with trust property only in ways which benefit the beneficiaries. These are not the personal assets of the trustee.

Trust funds that are not available for distribution or funds provided for items not covered by assistance are not assessed in calculating entitlement. Where payments are made from any trust fund for needs that assistance would cover, the payment is assessed as income.

Discretionary Trusts - A trust established as a result of a will where an individual named in the will as a trustee has complete control over the disposition of the funds. These are usually set up by the family for a family...

52 Ibid.
member with a disability. Funds released for the client’s basic needs are income. A copy of the will should be sent to Central Office for review.53

Assuming Darcie is receiving social assistance benefits and that Joe and Katey wish to maintain these benefits for her, they could set up Henson Trusts in their Wills for Darcie. Because the Ministry of Social Services would like to see copies of the documents creating the trusts, it is important that Henson Trusts/discretionary trusts are properly drafted so as to avoid any dispute regarding the disabled person’s entitlement to benefits. Darcie should not be a trustee of the trust. There should be no right given to Darcie to allow her to demand property from the trust and furthermore, none of the trust property should be vested indefeasibly in Darcie’s hands. The use of the trust funds must be in the absolute and unfettered discretion of the trustees. Further, the trust document should provide for a gift over of the remaining trust property that will be implemented once Darcie dies.

It is important to keep in mind that a Henson Trust/discretionary trust is helpful in ensuring that the trust property itself is not taken into account when determining entitlement to social assistance benefits. However, payments made to a beneficiary out of such a trust for needs that assistance would otherwise cover are taken into account as income for the beneficiary and reduce the beneficiary’s entitlement to such assistance payments.

(d) Life Insurance Trusts

As we all know, life insurance policies where there are named beneficiaries do not flow through the estate of a deceased insured but, rather, are paid directly to the designated beneficiaries of such policy. A life insurance trust is a trust that is set up to deal with any life insurance funds paid from a particular policy or policies. Whether a client requires a life insurance trust depends on what the client intends to have happen with the policy funds once he or she has passed away.

Again, we will come back to Joe and Katey. Let’s say that Joe secures a life insurance policy for $500,000.00 and wishes for the policy to ultimately be paid to Allie (remember, she is currently 17). If Joe simply designates Allie as beneficiary of his life insurance policy without doing anything more and he passes away before she turns 18, the life insurance proceeds would be held in trust for Allie until she turns 18. Then, at age 18, the amount that was in trust would be transferred outright to Allie. In this scenario, Joe does not want Allie to receive $500,000.00 when she turns 18 because of the potential for such funds to be wasted due to her immaturity. Ideally, he would like Allie to receive a small portion of the life insurance policy at age 18 (perhaps 5%), a bit more at age 21 (maybe 15%) and the rest at age 25. There are two ways he can accomplish this:

(a) Joe can either leave the life insurance policy without a designated beneficiary or designate his estate as its beneficiary. In Joe’s Will, he can provide, by way of specific gift, that the life insurance policy is to be paid to Allie. The Will would contain trust provisions that state that, while such child is under age 25, her share would be held in trust with payments of capital at ages 18, 21 and 25 as set out above coming from the trust. Here’s the issue, though. The life insurance policy would flow through the estate. Probate would likely be required, and the court charges a probate fee of 0.7% of the value of the estate at the time the probate application is made. On $500,000.00, this equates to a probate fee of $3,500.00 that would need to come out of estate funds; or

(b) Joe could designate, in the life insurance policy, that a separate trust for Allie will be the beneficiary under such policy. The funds would be held in accordance with the terms of such insurance trust. The insurance trust (which would be a document separate from Joe’s Will) would provide that the funds are to be held in trust for Allie’s benefit, and it would also provide for distributions at ages 18, 21 and 25 as set out above. Basically, management of the life insurance funds would need to occur in accordance with the terms of the life insurance trust. The benefit to arranging things in this manner is that, because the insurance trust is the designated beneficiary of the life insurance policy, that life insurance policy does not pass through Joe’s estate and no probate fees will be required to be paid on the value of that life insurance policy. In the example above, that would mean $3,500.00 in savings to the estate.

Essentially, a life insurance trust becomes a “Will” for the life insurance proceeds. It dictates how the funds are to be managed once the insured passes away. In the example above, we dealt with a child in her minority. However, life insurance trusts could be used for adult beneficiaries as well if the insured person wishes to dictate how the insurance funds are to be handled after he or she passes on. Aside from issues of probate costs, there may be other reasons to have life insurance pass outside of an estate, such as for the possible protection of the life insurance proceeds from creditors who might have a claim against Joe’s estate.

C. How are Testamentary Trusts Taxed?

(a) Tax Rates – Changing Rules

A testamentary trust is a separate taxpayer from its beneficiaries. Any income that is retained within the testamentary trust will be subject to the trust’s applicable tax rates. Thus, for example, where one spouse dies and leaves property to a testamentary spousal trust, we are left with a situation where we continue to have two taxpayers “in the family”, namely the surviving spouse and the spousal trust.

Historically, testamentary trusts enjoyed a preferred tax position as compared to inter vivos trusts. This was due to the fact that testamentary trusts were subject to graduated tax rates and brackets, much like a “flesh and blood” individual. In 2013, the federal government announced that it was reviewing the tax rules in
relation to testamentary trusts and invited submissions to be made to the Department of Finance in connection with this matter. Essentially, the federal government was considering making numerous tax changes including the following:

(a) The flat high marginal tax rate would apply to testamentary trusts (save and except for estates which would benefit from graduated rates for a 36 month period);
(b) The installment rules would be extended to testamentary trusts. Up to that point in time, testamentary trusts were required to pay tax owing within 90 days following their year-ends;
(c) The $40,000.00 basic exemption from alternative minimum tax would no longer apply to testamentary trusts; and
(d) Testamentary trusts would be required to use a calendar year-end.

Among others, the Society of Trust and Estate Practitioners of Canada (“STEP Canada”) made a number of submissions to the federal government. Essentially, STEP Canada took the view that the consultation paper published by the Department of Finance contained no empirical or tax policy analysis that justified the proposed changes to the tax rules governing testamentary trusts. Submissions were made that if there was to be a reform of trust taxation, there should be a more comprehensive review of the rules and how they might apply, rather than the focus being on testamentary trusts and increasing the ultimate tax burden on those trusts. The STEP Canada submission was made to the Department of Finance on December 2, 2013. On February 11, 2014, the Minister of Finance presented its budget for the year. The 2014 budget proposed to proceed with the measures to eliminate the tax benefits as originally proposed in the 2013 budget and apply the flat top-rate of taxation to estates and trusts with the exception of the following:

(a) Graduated rates would continue to be available for the first 36 months of an estate that qualifies as a testamentary trust;
(b) If the estate remains in existence more than 36 months after the death of the individual, it would be subject to flat top-rate taxation at the end of that period; and
(c) An exception to this tax regime was granted and graduated tax rates would continue to apply to testamentary trusts that have individuals eligible for the federal disability tax credit as beneficiaries.

These changes will apply to 2016 and subsequent taxation years.

One of the consequences of these new rules is that, in the absence of a situation where the beneficiaries of a testamentary trust include individuals who have obtained the federal disability tax credit certificate, it may be advisable for estates (at least those with significant assets) to be kept in existence for 36 months following the death of the individual. If this is the desired objective, wording in Wills should be reviewed in order to ensure that the executors of the estate have the power to retain income within the estate and have it taxed within the estate for at least 36 months following the death of the testator. In this way, three years of
estate income could be eligible for graduated income tax rates under the new rules.

Following the announcement of the 2014 Federal Budget, there were some tax advisors who were of the view that testamentary trust planning would no longer be appropriate or useful. With respect, there are several reasons why testamentary trust planning should continue to have an important place in the planning considerations for clients. The reasons for this include the following:

(a) Notwithstanding that in many circumstances, the graduated income tax rates that historically applied to testamentary trusts will no longer apply in the future (or only apply for a limited time period), all of the other advantages associated with trust planning continue to apply. To put this another way, the elimination of graduated income tax rates for testamentary trusts is only one consideration in determining whether or not trust planning can be useful in connection with the circumstances facing a client. If a client wishes to make use of the other advantages that can arise with trust planning (e.g. protection of property), then it still makes sense to utilize testamentary trusts in estate and other planning.

(b) Keep in mind that the situation that confronts your client at the time that you are making the Wills could change between now and the time of their death. Consider a situation where you are meeting with a husband and wife who are in relatively good health. They make their Wills with you at a point in time where neither one of them is disabled. However, with the passage of years, it may well turn out that upon the death of the first spouse, the other spouse is at that point in time disabled and is eligible for a federal disability tax credit certificate. By providing the flexibility in the Will to allow, for example, for a testamentary trust for the benefit of the surviving spouse, the planner can create a Will that allows not only for the protection of property but for the future tax benefits of graduated income tax rates in that particular testamentary trust.

(b) 21 Year Rule and Trust Wind-Up

Earlier in this paper we discussed circumstances where the 21 year deemed disposition rule can apply and how trusts may be wound up. When drafting testamentary trusts, one thing that should be kept in mind is that you may wish to draft the Will or testamentary documents in such a way that, upon the death of the first spouse, provision is made to allow assets to be transferred into a spousal trust for the benefit of the surviving spouse. Typically the capital property of the deceased spouse can be transferred into the spousal trust on a tax rollover basis.\(^{54}\) Upon the death of the second spouse, the remaining trust property (subject to the payment of applicable income taxes) can then be transferred to successor trusts. Each successor trust can be established for the benefit of a particular child and his or her issue. Ultimately, care must be taken with the successor trusts regarding the 21 year rule and the deemed disposition of trust property at that time. With

\(^{54}\) Act, supra note 3, s. 70(6).
respect to these testamentary trusts, the same considerations noted earlier in this paper in connection with the application of the 21 year rule and the ability to wind-up trusts continue to apply.

IV. RDSP

A. What is an RDSP?

RDSP stands for registered disability savings plan. The tax provisions applicable to RDSPs are, generally, found in section 146.4 of the Act. RDSPs are savings arrangements through which individual contributions, government grants and government bonds are invested on a tax deferred basis for the benefit of a person who is eligible for the disability tax credit. RDSPs are intended to be long term savings plans. If certain funds are withdrawn from an RDSP within 10 years of such funds having been contributed to the RDSP, the withdrawal could trigger payback of certain benefits.

RDSPs are typically set up at financial institutions or investment companies. If you find yourself representing an institution or company that wishes to set itself up as an issuer of RDSPs, the requirements set out in section 146.4(2) must be met. The plan itself must meet all of the conditions (and there are a large number of them) set out in section 146.4(4) of the Act. For the purposes of this paper, we do not intend to go into these requirements and conditions. Rather, we are looking at RDSPs from the viewpoint of the disabled person and his or her parents, guardians and other people who wish to contribute to the disabled person’s savings.

B. How does an individual qualify for the RDSP?

In order to be a beneficiary of an RDSP, an individual must meet the following four requirements:

(a) The individual must be eligible for the disability tax credit (“DTC”);
(b) The individual must have a valid social insurance number;
(c) The individual must be a resident of Canada; and
(d) The individual must be under the age of 60 (however, the age limit does not apply if the only reason the RDSP is opened is because funds are transferred from the same beneficiary’s previous RDSP into the newly-opened RDSP).

The last 3 requirements are self-explanatory. The vast majority of the issues typically arise in determining whether or not an individual is eligible for the DTC. The DTC is a non-refundable tax credit that a person with a severe and prolonged impairment in physical or mental functions can claim to reduce the amount of income tax he or she has

56 These will be discussed later in this paper.
to pay in a year. 58 For the purposes of the RDSP, section 146.4(1) contains a definition for “DTC-eligible individual” which reads as follows:

“DTC-eligible individual”, in respect of a taxation year, means an individual in respect of whom an amount is deductible, or would if this Act were read without reference to paragraph 118.3(1)(c) be deductible, under section 118.3 in computing a taxpayer’s tax payable under this Part for the taxation year.

Section 118.3 of the Act sets out the requirements to be met for someone to qualify for the disability tax credit. The full text of this legislative provision as well as section 118.4 (which is also relevant) are set out in Appendix 1 to this paper.

Because these provisions are written in the typical indecipherable Income Tax Act-style of drafting, it is important to distill them down to these basic points. In order to qualify for the DTC, an individual must have “one or more severe and prolonged impairments in physical or mental functions,”59 the effects of which either (a) significantly restrict56 the individual’s ability to perform more than one basic task where the effect of those restrictions creates a marked restriction61 on the part of the individual to perform such tasks, or (b) the individual’s ability to perform such tasks would be so restricted if it wasn’t for certain types of therapies that are being provided to the individual.62 Those tasks that are considered basic activities of daily living and mental functions are listed in paragraphs 118.4(1)(c) and (c.1) of the Act.63 In order for the impairment to be prolonged, it must be continuous, or expected to be continuous, for at least 1 year.64 If someone is blind, or if he or she is unable to, or require an inordinate amount of time to, perform a basic activity, all or substantially all of the time, he or she would be considered markedly restricted by his or her disability.65

A medical practitioner must certify the disability using Form T2201, Disability Tax Credit Certificate.66 “Medical practitioner” is not necessarily limited to a medical doctor. Paragraphs 118.3(1)(a.2) and (a.3) list other medical professionals who can provide opinions in selected circumstances (for example, if the individual has a hearing impairment, an audiologist could complete Form T2201). Form T2201 must be submitted to the Canada Revenue Agency for approval. It is only once the CRA has validated such form that the person is deemed eligible for the DTC. Since 2010, individuals have had the option of requesting that the Minister of National Revenue make a determination as to eligibility for the DTC ahead of time by sending in the necessary forms to allow the CRA to do this. Once the CRA has made its determination, a notice is sent to the individual.67

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59 Act, supra note 3, s. 118.3(1)(a).
60 Ibid., s. 118.3(1)(a.1).
61 Ibid.
62 Ibid.
63 With qualifications at paragraphs 118.4(d), (e) and (f) of the Act.
64 Act, supra note 3, s. 118.4(1)(a).
65 Ibid., s. 118.4(1)(b).
66 Ibid., s. 118.3(1)(a.2).
67 RDSP Paper, supra note 57, at p. 2.
C. How are RDSPs opened and who can hold an RDSP?

There are three principal parties relevant to the establishment of an RDSP, namely the:

(a) Beneficiary;
(b) Issuer; and
(c) Plan Holder.

The beneficiary of an RDSP is the individual who qualifies for the DTC (as discussed above). At any given time, a beneficiary can only have one RDSP.68

Issuers of RDSPs are typically financial institutions that offer RDSPs as savings mechanisms to those who qualify for them (or those entities who are able to set up RDSPs on behalf of qualifying individuals). These financial institutions include banks or investment companies. To set up an RDSP, a plan holder would contact a participating issuer.

The plan holder is the person who opens the RDSP and who “makes or authorizes contributions on behalf of the beneficiary”69. The beneficiary can be the plan holder, or “[a] qualified person, who is legally authorized to act for the beneficiary, can open an RDSP for the individual and become a holder.”70 The plan holder does not have to be a resident of Canada.71 The RDSP “can have several plan holders throughout its existence, and it can have more than one plan holder at any given time.”72

Who can qualify as a plan holder depends on the disabled person’s age and legal capacity to contract at the particular time. Below we consider the four scenarios and explain who can open an RDSP in each situation.73

The Beneficiary is Under the Age of Majority

If the beneficiary has not yet reached the age of majority,74 one of the following persons (defined as a “qualifying person” in subsection 146.4(1) of the Act) can open up an RDSP and be the plan holder for the disabled individual:

(a) a legal parent of the beneficiary,
(b) a guardian, tutor, curator or other individual who is legally authorized to act on behalf of the beneficiary, or

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68 Ibid.
69 Ibid.
70 Ibid., at p. 3.
71 Government of Canada, Eligibility and Contributions sheet, http://www.cra-arc.gc.ca/tx/ndvlts/tpcs/rdsp-reei/ctrbtn-eng.html (“Eligibility Sheet”). This only applies if the beneficiary and plan holder are not one and the same person, since one of the requirements to qualify for the DTC states that the beneficiary must be a Canadian resident.
72 Ibid.
73 Note that the information on the four points below is taken, in large part, from the RDSP Paper, supra note 57.
74 In Saskatchewan, the age of majority is 18 years. See The Age of Majority Act, R.S.S. 1978, c. A-6, s. 2.
(c) a public department, agency or institution that is legally authorized to act on behalf of the beneficiary.\(^75\)

The Beneficiary has reached the Age of Majority and is Legally Able to Contract

If the beneficiary has reached the age of majority (18 in Saskatchewan) and he or she has the ability to legally enter into a contract, the beneficiary can establish an RDSP for himself or herself. If the beneficiary’s parents have already set up an RDSP for the beneficiary, the parents may choose (a) to remain as the plan holders, (b) to add the beneficiary to the RDSP as a joint holder, or (c) to remove themselves as plan holders and allow the beneficiary to become the sole plan holder of the RDSP. If a plan is opened by somebody other than the beneficiary or the beneficiary’s parents before the beneficiary turns 18, that person or body generally must be removed as a holder of the plan when the beneficiary reaches the age of majority.\(^76\)

The Beneficiary has reached the Age of Majority but is not Legally Able to Contract

If a beneficiary has reached the age of majority but is not legally able to enter into a contract, a “qualifying person” can open an RDSP and be its plan holder. In this case, the “qualifying person” would be:

(a) A guardian, tutor, curator or other individual who is legally authorized to act on behalf of the beneficiary; or
(b) A public department, agency or institution that is legally authorized to act on behalf of the beneficiary.\(^77\)

Contrast this with the persons who are able to be a plan holder of an RDSP for a beneficiary who is under the age of 18 years. Notice that the reference to parent as a category of its own is missing. This means that, once a beneficiary who does not have capacity to enter into contracts turns 18, that beneficiary’s parents do not technically have the ability to open an RDSP on behalf of their disabled child unless they are “legally authorized to act on behalf of the beneficiary”. To be so legally authorized would mean that such parents would need to secure a guardianship order for their disabled child at the time he or she turns 18.

If, however, a parent had already opened up an RDSP for a beneficiary while that beneficiary was under the age of 18 years, when that beneficiary reaches the age of 18 years but is unable to legally enter into a contract, it is not as clear as one would expect whether or not the parent can remain the plan holder of the beneficiary’s RDSP without obtaining a guardianship order. One commentator has stated that the parent can continue as the plan holder without a guardianship order.\(^78\) However, in the writers’ own communications with Canada Revenue Agency on this point, no definitive answer was

\(^{75}\) Act, supra note 3, s. 146.4(1), definition of “qualifying person”.


\(^{77}\) Act, supra note 3, s. 146.4(1), part (b) of the definition of “qualifying person”.

\(^{78}\) Golombek, supra note 55.
provided as to whether or not the parent needed to obtain a guardianship order upon the child turning 18 years of age should the parent wish to remain as the plan holder. Section 146.4(4)(c) of the Act indicates that where an entity other than a “qualified family member” (which includes a parent) ceases to be a qualifying person in relation to the beneficiary, that entity ceases to be a plan holder. By carving out an exception for parents, it appears that a parent can continue to be a plan holder after the beneficiary turns 18. This makes logical sense, however, we were unable to secure reassurance from Canada Revenue Agency that this is the case.\textsuperscript{79}

The Beneficiary has reached the Age of Majority but his or her legal ability to contract is in doubt

If, after reasonable inquiry, an RDSP issuer determines that the beneficiary’s ability to enter into a contract is doubtful, a "qualifying family member" can open up an RDSP for the beneficiary. The definition of “qualifying family member” is as follows:

“qualifying family member”, in relation to a beneficiary of a disability savings plan, at any time, means an individual who, at that time, is

(a) a legal parent of the beneficiary; or

(b) a spouse or common-law partner of the beneficiary who is not living separate and apart from the beneficiary by reason of a breakdown of their marriage or common-law partnership.\textsuperscript{80}

If:

(a) after reasonable inquiry, the issuer comes to the opinion that there are no longer any concerns with the beneficiary’s ability to enter into a contract and the beneficiary notifies the issuer that he or she wishes to become the plan holder,

(b) a competent tribunal or other authority determines that the beneficiary is contractually competent and the beneficiary wishes to become the plan holder, or

(c) a legal representative is subsequently appointed with respect to the beneficiary,

the “qualifying family member” is no longer able to be a plan holder for the beneficiary. With respect to the appointment of a legal representative referred to in (c) above, in that case, such representative will replace the qualifying family members as the plan holder upon his/her/its appointment as legal representative.

The rules above with respect to the ability of a “qualifying family member” to open up an RDSP have been in effect since June 29, 2012 and will end on December 31, 2016.\textsuperscript{81} Presumably, after that time, the beneficiary would either fall into the categories of an adult who is able to enter into a contract legally or one who is not, and the issuer will no longer have the ability to determine whether someone’s capacity is questionable.

\textsuperscript{79} Although, in speaking with financial advisors, we are told that, practically, this is what happens in the administration of RDSPs.

\textsuperscript{80} Act, supra note 3, s. 146.4(1), definition of “qualifying family member”.

\textsuperscript{81} RDSP Paper, supra note 57, at p. 3.
If an RDSP has already been opened for a beneficiary or if a legal representative is able to act on behalf of a beneficiary who is over the age of majority, the rules allowing for a “qualifying family member” to open up an RDSP for a beneficiary whose capacity is in question, as discussed immediately above, do not apply.\footnote{Ibid.}

D. \textbf{How is money contributed to an RDSP?}

It is important to first note that there is no annual limit on contributions that can be made to an RDSP. However, there is a lifetime contribution limit of $200,000.00 per beneficiary.\footnote{Government of Canada, Employment and Social Development Canada, Registered Disability Savings Plan webpage, \url{http://www.esdc.gc.ca/eng/disability/savings/index.shtml}. See also Government of Canada, Service Canada, Registered Disability Savings Plan webpage, \url{http://www.servicecanada.gc.ca/eng/goc/rdsp.shtml} (“Service Canada Webpage”).}

The plan holder controls who can contribute to an RDSP. There are no limitations on who may contribute, but the written permission of the plan holder is required for all contributions.\footnote{Eligibility Sheet, \textit{supra} note 71.} In addition to contributions to an RDSP that are made by a plan holder or any other person approved by the plan holder, “[c]ontributions to RDSPs may be supplemented by a Canada Disability Savings Grant and a Canada Disability Savings Bond.”\footnote{Service Canada Webpage, \textit{supra} note 83. Authority for the government of Canada to pay the Canada Disability Savings Grant and Canada Disability Savings Bond is contained in the \textit{Canada Disability Savings Act}, S.C. 2007, c. 35.}

The Canada Disability Savings Grant (“CDSG”) is a grant that the government of Canada contributes to an RDSP. CDSGs can be paid into an RDSP up until the end of the year in which the beneficiary turns 49. The maximum annual CDSG is $3,500.00, with a lifetime limit of $70,000.00.\footnote{Service Canada Webpage, \textit{supra} note 83; Government of Canada, Employment and Social Development Canada, Grants and Bonds web page, \url{http://www.esdc.gc.ca/eng/disability/savings/grants_bonds.shtml}; RDSP Paper, \textit{supra} note 57, at p. 1.}

Contributions must be made to an RDSP to receive the CDSG. The CDSG is a matching grant that is calculated by taking into account the beneficiary’s family income and amount contributed. The beneficiary’s family income is calculated in the following manner:

- From birth to December 31 of the year the beneficiary turns 18, the beneficiary’s family income is based on the income information used to determine the Canada Child Tax Benefit (CCTB) for that beneficiary.
- Beginning the year the beneficiary turns 19 until the RDSP is closed, the beneficiary’s family income is based on his or her income plus his or her spouse’s, or common law partner’s income. To qualify for the bond or to earn a grant, the beneficiary must file income tax returns for the past two years and all future taxation years when he or she has an RDSP.
If the beneficiary is under the care of a department, agency, or institution for at least one month in the year, the grant is based on the allowance payable to the department, agency, or institution under the *Children’s Special Allowances Act*.\(^{87}\)

The Government of Canada Employment and Social Development Canada website indicates that, for 2014, the amount of the CDSG will be based on the beneficiary’s family income as follows: \(^{88}\)

<table>
<thead>
<tr>
<th>Beneficiary’s family income</th>
<th>Grant</th>
<th>Contribution Amount</th>
<th>Maximum Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>$87,907 or less</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>on the first $500</td>
<td>$3 for every $1 contributed</td>
<td>$500</td>
<td>$1,500</td>
</tr>
<tr>
<td>on the next $1,000</td>
<td>$2 for every $1 contributed</td>
<td>$1,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>more than $87,907</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>on the first $1,000</td>
<td>$1 for every $1 contributed</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$2,500</td>
<td>$4,500</td>
</tr>
</tbody>
</table>

In addition to the CDSG, the government of Canada can also contribute a Canada Disability Savings Bond (“CDSB”) to an RDSP. Like the CDSG, the CDSB is paid into the RDSP up until the end of the year in which the beneficiary turns 49. The annual limit for a CDSB is $1,000.00 per year, depending on the beneficiary’s family income, with a limit of $20,000.00 over the beneficiary’s lifetime. \(^{89}\)

Unlike the CDSG, no contributions are required to be made to the RDSP in order to receive the CDSB, \(^{90}\) although it is still necessary to set up the RDSP in order to receive the bond. The amount of the CDSB that was available to be contributed to an RDSP in 2014 is based on the beneficiary’s family income as follows: \(^{91}\)

<table>
<thead>
<tr>
<th>Beneficiary’s family income</th>
<th>Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>$25,584 or less (or if the holder is a public institution)</td>
<td>$1,000</td>
</tr>
<tr>
<td>Between $25,584 and $43,953</td>
<td>Part of the $1,000 based on the formula in the <em>Canada Disability Savings Act</em></td>
</tr>
<tr>
<td>more than $43,953</td>
<td>No bond is paid</td>
</tr>
</tbody>
</table>


\(^{90}\) *Ibid.*

\(^{91}\) Quick Facts Webpage, *supra* note 88.
With respect to the tables for both the CDSG and CDSB, note that these are the 2014 numbers. These amounts are indexed to inflation each year.\(^{92}\)

CDSG and CDSB entitlements can be carried forward to future years. “The carry forward period can only start after 2007 and lasts for 10 years. Grants and bonds will be paid on unused entitlements up to an annual maximum of $10,500 for grants and $11,000 for bonds.”\(^{93}\)

E. How is money withdrawn from an RDSP?

The beneficiary of an RDSP owns the RDSP and its property. RDSP payments can only be made to a beneficiary or, if the beneficiary has died, to the beneficiary’s estate. People who contribute to the RDSP are not able to get a refund of their contributions.\(^{94}\) Any private contributions to the RDSP, income earned on investments within the RDSP, and CDSGs and CDSBs that have been in the RDSP for more than 10 years can be paid to the beneficiary or the beneficiary’s estate.\(^{95}\)

However, any CDSGs and CDSBs that have been in the RDSP for less than 10 years must be repaid by the beneficiary when funds are withdrawn from an RDSP. Government documentation indicates that the beneficiary must repay “$3 for every $1 that is taken out, up to the total amount of grants and bonds paid into the RDSP in the last 10 years. Repayments to the Government of Canada will be applied starting with the oldest grants and bonds paid into the plan first, and then towards the newest.”\(^{96}\)

The RDSP is terminated at the end of the year following the year in which the beneficiary dies. Provided that the individual beneficiary makes a Will, the RDSP property will be distributed in accordance with the terms of that Will. However, if the beneficiary is not competent to make a Will (or for whatever reason has not made a legal Will), then the RDSP property will be distributed in accordance with the rules of intestacy.

The beneficiary must begin receiving payments from the RDSP by the end of the year in which he or she turns 60.\(^{97}\) The amount of payments are subject to maximum annual withdrawal limits based on the life expectancy and age of the beneficiary, and the fair market value of the property in the RDSP. There are three types of distributions which may be made out of an RDSP:

(a) Disability Assistance Payments (“DAP”)s;
(b) Lifetime Disability Assistance Payments (“LDAP”)s; and
(c) Specified Disability Payments.

\(^{92}\) RDSP Paper, supra note 57, at p.1.
\(^{93}\) Ibid., at p. 2.
\(^{94}\) Eligibility Sheet, supra note 71.
\(^{96}\) Ibid.
\(^{97}\) Act, supra note 3, s. 146.4(4)(k).
Disability Assistance Payments (“DAP”s)

A disability assistance payment is defined as “any payment made from the plan to the beneficiary or the beneficiary’s estate.” DAPs may be paid out of a plan at any time, however, whether such payments can be made (or whether only LDAPs can be made) will depend on the terms of the RDSP itself. No DAP can be made “if it would result in the fair market value of the property held by the plan trust immediately after the payment being less than the assistance holdback amount in relation to the plan.” The “assistance holdback amount” is defined in the Canada Disability Savings Regulations as:

\[
\begin{align*}
(a) & \quad \text{in the case of an RDSP that is, at the particular time, a specified disability savings plan, nil;} \\
(b) & \quad \text{in any other case, the total amount of bonds and grants paid into an RDSP within the 10-year period before the particular time, less any amount of bond or grant paid in that 10-year period that has been repaid to the Minister.}
\end{align*}
\]

Essentially, any amount of CDSG and CDSB that is paid into the RDSP in the 10 year period before a payment is taken out will be required to be repaid. It is only after the CDSG and CDSB have been in the RDSP for 10 years that it can be paid out to the beneficiary of the RDSP. When payments are made out of an RDSP and there are CDSGs and CDSBs that have been contributed both before the 10 year time period and afterwards, the oldest contributions are taken into account first.

Lifetime Disability Assistance Payments (“LDAP”s)

The following is the full definition of lifetime disability assistance payment, as set out in the Act:

“lifetime disability assistance payments” under a disability savings plan of a beneficiary means disability assistance payments that are identified under the terms of the plan as lifetime disability assistance payments and that, after they begin to be paid, are payable at least annually until the earlier of the day on which the beneficiary dies and the day on which the plan is terminated. LDAPs must start no later than the year that the beneficiary turns 60. Once the beneficiary has elected to begin receiving these payments, there must be a payment made out of the RDSP every year. Annual LDAPs cannot exceed an amount determined by the following formula, which is based on the beneficiary’s age and the current fair market value of the RDSP:

98 Ibid., s. 146.4(1), definition of “disability assistance payment”.
99 Ibid., s. 146.4(4)(m).
100 Ibid., s. 146.4(4)(j).
101 Canada Disability Savings Regulations, SOR/2008-186, s. 1, definition of “assistance holdback amount”.
102 Withdrawal Webpage, supra note 95.
103 Act, supra note 3, s. 146.4(4)(k).
\[
\frac{A}{B + 3 - C} + D
\]

where

A is the fair market value of the property held by the plan trust at the beginning of the calendar year (other than annuity contracts held by the plan trust that, at the beginning of the calendar year, are not described in paragraph (b) of the definition “qualified investment” in subsection 205(1)),

B is the greater of 80 and the age in whole years of the beneficiary at the beginning of the calendar year,

C is the age in whole years of the beneficiary at the beginning of the calendar year, and

D is the total of all amounts each of which is

(i) a periodic payment under an annuity contract held by the plan trust at the beginning of the calendar year (other than an annuity contract described at the beginning of the calendar year in paragraph (b) of the definition “qualified investment” in subsection 205(1)) that is paid to the plan trust in the calendar year, or

(ii) if the periodic payment under such an annuity contract is not made to the plan trust because the plan trust disposed of the right to that payment in the calendar year, a reasonable estimate of that payment on the assumption that the annuity contract had been held throughout the calendar year and no rights under the contract were disposed of in the calendar year.\(^\text{104}\)

The purpose of the above formula is to “allow the RDSP assets to be paid out more or less evenly over the beneficiary’s remaining years.”\(^\text{105}\) Once the beneficiary reaches the age of 80 years, “the annual limit on LDAPs will be equal to one-third of the RDSP’s opening assets that year.”\(^\text{106}\)

**Specified Disability Payments**

Specified Disability Payments can be made when an RDSP becomes a Specified Disability Savings Plan (“SDSP”). SDSPs are designed to assist individuals who are unlikely to survive for more than 5 years. In order to have an RDSP become an SDSP, the requirements of subsection 146.4(1.1) of the Act must be met. Subsection 146.4(1.1) reads as follows:

If, in respect of a beneficiary under a registered disability savings plan, a medical doctor licensed to practise under the laws of a province (or of the place where the beneficiary resides) certifies in writing that the beneficiary’s state of health is such that, in the professional opinion of the medical doctor, the beneficiary is not likely to survive more than five years, the holder of the plan elects in prescribed form and provides the election and the medical certification in respect of the beneficiary to the issuer of the plan, and the issuer notifies the specified Minister of the election in a manner and format acceptable to

\(^\text{104}\) *Ibid.*, s. 146.4(4)(1).
\(^\text{105}\) *Golombek, supra* note 55.
the specified Minister, then the plan becomes a specified disability savings plan at the
time the notification is received by the specified Minister.

Once an RDSP becomes an SDSP, no further contributions may be made to it.\(^{107}\) Essentially, RDSP beneficiaries who have a shortened life expectancy can have greater access to RDSP funds. “Withdrawals made at any time following a 146.4(1.1) election will not trigger the repayment of CDSGs and CDSBs provided that the total of the taxable portions of the withdrawals do not exceed $10,000 annually.”\(^{108}\) In addition, beneficiaries can withdraw a pro-rated amount of their plan contributions.\(^{109}\) Repayment of any remaining grants and bonds paid into the plan within the preceding 10 years is not required until the death of the beneficiary.”\(^{110}\)

F. How are withdrawals from RDSPs taxed?

Contributions to an RDSP can be made until the end of the year that the beneficiary turns 59. “Contributions to an RDSP are not tax deductible.”\(^{111}\) Any investment income earned within the RDSP accrues tax-free.\(^{112}\) As distributions are made out of the RDSP to the beneficiary, the beneficiary will receive a proportionate share tax-free (in relation to individual contributions previously made to the RDSP) with the balance being taxable (in relation to investment income earned within the RDSP, and CDSGs and CDSBs received by the RDSP).\(^{113}\)

G. Why is the RDSP a good thing?

Money paid out of an RDSP does not typically affect the beneficiary’s eligibility for other benefits. Specifically, the beneficiary’s ability to receive federal program funds for Old Age Security, the Goods and Services Tax credit, Employment Insurance or the Canada Child Tax Benefit are not jeopardized by an RDSP.\(^{114}\)

Canadian provinces and territories also provide further social assistance funding for disabled people. “All provinces and territories fully or partially exempt Registered Disability Savings Plan (RDSP) assets and income”\(^{115}\) from being taken into account when determining an individual’s entitlement to social assistance programming. The province of Saskatchewan is one of the provinces that fully exempts RDSP assets and income from being considered when it comes to social assistance. This exemption includes not only the existence of the RDSP but also all payments made from an RDSP to

\(^{107}\) RDSP Paper, supra note 57, at p. 5.
\(^{108}\) Ibid.\(^{108}\) “Total annual withdrawals may exceed $10,000.00 due to the non-taxable portions.”: Act, notes to s. 146.4(1.1).
\(^{109}\) RDSP Paper, supra note 57, at p. 8.
\(^{110}\) Withdrawal Webpage, supra note 95.
\(^{111}\) RDSP Paper, supra note 57, at p. 1.
\(^{113}\) RDSP Paper, supra note 57. See also RDSP Webpage, supra note 112.
\(^{115}\) Ibid.
its beneficiary.\textsuperscript{116} This policy is set out in section 18.3.3 of the Saskatchewan Assistance Program Policy Manual\textsuperscript{117} and section 28(2)(y.2) of \textit{The Saskatchewan Assistance Regulations}.\textsuperscript{118}

V. CONCLUSION

How do the trust and RDSP topics tie together? Qualification for the disability tax credit is the link between the RDSP and the use of trusts for disabled beneficiaries in estate planning (specifically, the use of testamentary trusts and the entitlement to the graduated income tax rates in connection with those trusts after 2016).

Historically, one of the fundamental purposes of trusts was for the protection of property for beneficiaries. In Canada, we have the benefit of a universal health care system coupled with a social benefit system that provides economic assistance to those persons, including disabled persons, who would otherwise find it difficult to earn a living based on their physical or mental abilities. It is quite common for lawyers to be retained to provide estate planning and legal assistance to families who have one or more members who are subject to a disability. Consider also that with an aging population in Canada, we are likely to see a greater percentage of the population suffer from some form of disability prior to death. Taking all of this into account, it is useful for lawyers to have an understanding as to how trusts and RDSPs work when advising clients, in particular those clients (or someone who they wish to benefit) who currently suffer or are likely to suffer from a disability at some point in time in the future.


\textsuperscript{117} SAP Policy Manual, \textit{supra} note 18, s. 18.3.3.

\textsuperscript{118} \textit{The Saskatchewan Assistance Regulations}, Saskatchewan Regulation 78/66, s. 28(2)(y.2).
VI. APPENDIX 1

118.3 (1) Where

(a) an individual has one or more severe and prolonged impairments in physical or mental functions,

(a.1) the effects of the impairment or impairments are such that the individual’s ability to perform more than one basic activity of daily living is significantly restricted where the cumulative effect of those restrictions is equivalent to having a marked restriction in the ability to perform a basic activity of daily living or are such that the individual’s ability to perform a basic activity of daily living is markedly restricted or would be markedly restricted but for therapy that

(i) is essential to sustain a vital function of the individual,

(ii) is required to be administered at least three times each week for a total duration averaging not less than 14 hours a week, and

(iii) cannot reasonably be expected to be of significant benefit to persons who are not so impaired,

(a.2) in the case of an impairment in physical or mental functions the effects of which are such that the individual’s ability to perform a single basic activity of daily living is markedly restricted or would be so restricted but for therapy referred to in paragraph (a.1), a medical practitioner has certified in prescribed form that the impairment is a severe and prolonged impairment in physical or mental functions the effects of which are such that the individual’s ability to perform a basic activity of daily living is markedly restricted or would be markedly restricted, but for therapy referred to in paragraph (a.1), where the medical practitioner is a medical doctor or, in the case of

(i) a sight impairment, an optometrist,

(ii) a speech impairment, a speech-language pathologist,

(iii) a hearing impairment, an audiologist,

(iv) an impairment with respect to an individual’s ability in feeding or dressing themselves, an occupational therapist,

(v) an impairment with respect to an individual’s ability in walking, an occupational therapist, or after February 22, 2005, a physiotherapist, and

(vi) an impairment with respect to an individual’s ability in mental functions necessary for everyday life, a psychologist,

(a.3) in the case of one or more impairments in physical or mental functions the effects of which are such that the individual’s ability to perform more than one basic activity of daily living is significantly restricted, a medical practitioner has certified in prescribed form that the impairment or impairments are severe and prolonged impairments in physical or mental functions the effects of which are such that the individual’s ability to perform more than one basic activity of daily living is significantly restricted and that the cumulative effect of those restrictions is equivalent to having a marked restriction in the ability to perform a single basic activity of daily living, where the medical practitioner is, in the case of

(i) an impairment with respect to the individual’s ability in feeding or dressing themselves, or in walking, a medical doctor or an occupational therapist, and

(ii) in the case of any other impairment, a medical doctor,

has certified in prescribed form that the impairment is a severe and prolonged mental or physical impairment the effects of which are such that the individual’s ability to perform a basic activity of daily living is markedly restricted or would be markedly restricted but for therapy referred to in paragraph (a.1),
(b) the individual has filed for a taxation year with the Minister the certificate described in paragraph (a.2) or (a.3), and

(c) no amount in respect of remuneration for an attendant or care in a nursing home, in respect of the individual, is included in calculating a deduction under section 118.2 (otherwise than because of paragraph 118.2(2)(b.1)) for the year by the individual or by any other person,

there may be deducted in computing the individual’s tax payable under this Part for the year the amount determined by the formula

\[ A \times (B + C) \]

where

A is the appropriate percentage for the year,
B is $6,000, and
C is

(a) where the individual has not attained the age of 18 years before the end of the year, the amount, if any, by which

(i) $3,500

exceeds

(ii) the amount, if any, by which

(A) the total of all amounts each of which is an amount paid in the year for the care or supervision of the individual and included in computing a deduction under section 63, 64 or 118.2 for a taxation year

exceeds

(B) $2,050, and

(b) in any other case, zero.

(1.1) For the purpose of paragraph 118.3(1)(a.1), in determining whether therapy is required to be administered at least three times each week for a total duration averaging not less than an average of 14 hours a week, the time spent on administering therapy

(a) includes only time spent on activities that require the individual to take time away from normal everyday activities in order to receive the therapy;

(b) in the case of therapy that requires a regular dosage of medication that is required to be adjusted on a daily basis, includes (subject to paragraph (d)) time spent on activities that are directly related to the determination of the dosage of the medication;

(c) in the case of a child who is unable to perform the activities related to the administration of the therapy as a result of the child’s age, includes the time, if any, spent by the child’s primary caregivers performing or supervising those activities for the child; and

(d) does not include time spent on activities related to dietary or exercise restrictions or regimes (even if those restrictions or regimes are a factor in determining the daily dosage of medication), travel time, medical appointments, shopping for medication or recuperation after therapy.
(2) Where

(a) an individual has, in respect of a person (other than a person in respect of whom the person’s spouse or common-law partner deducts for a taxation year an amount under section 118 or 118.8) who is resident in Canada at any time in the year and who is entitled to deduct an amount under subsection (1) for the year,

(i) claimed for the year a deduction under subsection 118(1) because of

(A) paragraph (b) of the description of B in that subsection, or

(B) paragraph (c.1) or (d) of that description where the person is a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, nephew or niece of the individual, or of the individual’s spouse or common-law partner, or

(ii) could have claimed for the year a deduction referred to in subparagraph (i) in respect of the person if

(A) the person had no income for the year and had attained the age of 18 years before the end of the year, and

(B) in the case of a deduction referred to in clause (i)(A), the individual were not married or not in a common-law partnership, and

(b) no amount in respect of remuneration for an attendant, or care in a nursing home, because of that person’s mental or physical impairment, is included in calculating a deduction under section 118.2 (otherwise than under paragraph 118.2(2)(b.1)) for the year by the individual or by any other person,

there may be deducted, for the purpose of computing the tax payable under this Part by the individual for the year, the amount, if any, by which

(c) the amount deductible under subsection 118.3(1) in computing that person’s tax payable under this Part for the year exceeds

(d) the amount of that person’s tax payable under this Part for the year computed before any deductions under this Division (other than under sections 118 to 118.07 and 118.7).

(3) Where more than one individual is entitled to deduct an amount under subsection 118.3(2) for a taxation year in respect of the same person, the total of all amounts so deductible for the year shall not exceed the maximum amount that would be deductible under that subsection for the year by an individual in respect of that person if that individual were the only individual entitled to deduct an amount under that subsection in respect of that person, and where the individuals cannot agree as to what portion of the amount each can deduct, the Minister may fix the portions.

(4) Where a claim under this section or under section 118.8 is made in respect of an individual’s impairment

(a) if the Minister requests in writing information with respect to the individual’s impairment, its effects on the individual and, where applicable, the therapy referred to in paragraph (1)(a.1) that is required to be administered, from any person referred to in subsection (1) or (2) or section 118.8 in connection with such a claim, that person shall provide the information so requested to the Minister in writing; and

(b) if the information referred to in paragraph (a) is provided by a person referred to in paragraph (1)(a.2) or (a.3), the information so provided is deemed to be included in a certificate in prescribed form.
For the purposes of subsection 6(16), sections 118.2 and 118.3 and this subsection,

(a) an impairment is prolonged where it has lasted, or can reasonably be expected to last, for a continuous period of at least 12 months;

(b) an individual’s ability to perform a basic activity of daily living is markedly restricted only where all or substantially all of the time, even with therapy and the use of appropriate devices and medication, the individual is blind or is unable (or requires an inordinate amount of time) to perform a basic activity of daily living;

(b.1) an individual is considered to have the equivalent of a marked restriction in a basic activity of daily living only where all or substantially all of the time, even with therapy and the use of appropriate devices and medication, the individual’s ability to perform more than one basic activity of daily living (including for this purpose, the ability to see) is significantly restricted, and the cumulative effect of those restrictions is tantamount to the individual’s ability to perform a basic activity of daily living being markedly restricted;

(c) a basic activity of daily living in relation to an individual means

(i) mental functions necessary for everyday life,

(ii) feeding oneself or dressing oneself,

(iii) speaking so as to be understood, in a quiet setting, by another person familiar with the individual,

(iv) hearing so as to understand, in a quiet setting, another person familiar with the individual,

(v) eliminating (bowel or bladder functions), or

(vi) walking;

(c.1) mental functions necessary for everyday life include

(i) memory,

(ii) problem solving, goal-setting and judgement (taken together), and

(iii) adaptive functioning;

(d) for greater certainty, no other activity, including working, housekeeping or a social or recreational activity, shall be considered as a basic activity of daily living; and

(e) feeding oneself does not include

(i) any of the activities of identifying, finding, shopping for or otherwise procuring food, or

(ii) the activity of preparing food to the extent that the time associated with the activity would not have been necessary in the absence of a dietary restriction or regime; and

(f) dressing oneself does not include any of the activities of identifying, finding, shopping for or otherwise procuring clothing.

(2) For the purposes of sections 63, 64, 118.2, 118.3 and 118.6, a reference to an audiologist, dentist, medical doctor, medical practitioner, nurse, occupational therapist, optometrist, pharmacist, physiotherapist, psychologist, or speech-language pathologist is a reference to a person authorized to practise as such,

(a) where the reference is used in respect of a service rendered to a taxpayer, pursuant to the laws of the jurisdiction in which the service is rendered;
(b) where the reference is used in respect of a certificate issued by the person in respect of a taxpayer, pursuant to the laws of the jurisdiction in which the taxpayer resides or of a province; and

(c) where the reference is used in respect of a prescription issued by the person for property to be provided to or for the use of a taxpayer, pursuant to the laws of the jurisdiction in which the taxpayer resides, of a province or of the jurisdiction in which the property is provided.