DISABILITY ALERT

ARBUCKLE
Personal Wealth Strategies

***DISABILITY ALERT** is a commentary on topics of current interest – usually topics relating to planning for individuals with disabilities and changes to current tax and social assistance legislation. Professional advice should be obtained before acting on any of this information.*

ESTATE PLANNING – ALL OF OUR CHILDREN DESERVE A HOME

Here in Waterloo we really do live in a Blackberry world. Life's pretty good! Indeed, all of us as Canadians live in a country that is prosperous and with a social network that's not perfect but competitive with most others. And yet there are still people who fall between the cracks. Most of the time there's enough of family wealth to help out but sometimes it just doesn't happen.

Typical Family Solutions

I want to deal with a slice of financial planning that is often ignored because no practical solutions ever seem to get on the table – at least for the average Joe or Jane. To the point, this article will discuss ways of providing a home to a family member who can't do it themselves for reasons they don't now or perhaps never did control.

There are many variations of the problem but let me suggest just a few.

Maybe there's a son or daughter who has a physical or mental impairment and for whom financial possibilities are meagre at best. Then, there are those in the family who have limited skills and will never rise above a basic level of income or wealth and sometimes can't control their spending habits or financial vulnerability. And then there is the proverbial black sheep who refuses to comply with any rules and may live at a bare subsistence level. Still, they are all family and create a financial dilemma for parents and siblings as to what's fair and what's right. Facts may vary from situation to situation but this issue can affect people from all walks of life. There is no denying that some creative financial arrangements need to be found.

A Typical Family

Bill and Cindy are well into retirement and have come up against a problem they can't solve. They are comfortable financially and expect to have an estate of about $750,000 when they die. It will be divided equally amongst their three children – Betty, Helga and Tom. Betty and Tom are married with university educations. They earn good salaries and by most accounts are considered well off. Helga on the other hand hasn't done so well. She dropped out of school at an early age. She has never been able to keep a job for long and is living pretty much at the poverty line. She is a single mom with two children in their twenties but they no longer live with her.

Helga earns enough income to provide for the bare necessities but certainly cannot afford a home. She can put bread on the table, pay the rent and the light, heat and hydro but not much more. And yet, she is a good person who could use a hand up. Even if she did own a home, she might be vulnerable to being manipulated by others so having a lot of wealth is not practical.

The Family's Plans and Concerns

What are mom and dad to do? Mom wants to use Helga's future inheritance now to buy a home for Helga but practical old dad says no way – and he might have a point. But if the following issues can be solved, dad will agree.

- Preventing anyone from taking advantage of Helga financially
- Making sure that the property eventually passes to Helga's children
- Treating Helga and her family the same as the other children
- Qualifying the home as Helga's principal residence
- Keeping income taxes as low as possible

The primary issue is for Bill and Cindy is to find a way to provide a home for Helga. Since dad wants to be sure that Helga can't be duped out of the property, she obviously can't own it in her own name. This is the ideal situation to use a trust. Mom and dad should go to a lawyer and lay out their wishes and the concerns mentioned above and ask the lawyer to prepare a trust to take care of it. Once the details of the trust agreement are finalized, mom and dad will contribute $250,000 to the trust and the trust will buy a home for Helga.

The Terms of the Trust

Without getting into too much detail, the person who establishes the trust (in this case mom and dad) should not be a beneficiary of the trust or control it in any way. Otherwise, there will be adverse tax consequences. Therefore, they will need to find someone in the family to act as trustee. Trusts are difficult documents so if you are doing this you must find a lawyer who practices in trusts and estates. There are legal and income tax consequences and both need to be considered.

The trust document would give Helga the right to occupy the home as long as she wishes. On her death or upon her leaving the property, the trust would provide that ownership of the property would pass to Helga's children. A trust is the perfect vehicle to make sure that mom and dad's wishes for Helga and her children are carried out with the enduring legal checks and balances set out in the trust document. So far the plan accomplishes their first two objectives.

The transfer of $250,000 to the trust gives Helga and her children a one third interest in the estate and solves the fairness issue. There may need to be some flexibility in the distribution of estate assets down the line in order to preserve fairness but this can be accomplished by special language in the wills or tweaking wills through a codicil.

The Principal Residence Exemption

Now for the principal residence issues. Tax law contemplates situations where a principal residence is owned by a trust to meet special family objectives as outlined above. The definition of a principal residence in the Income Tax Act includes property owned by a trust that "was ordinarily inhabited by a specified beneficiary of the trust". Briefly, a specified beneficiary is a person who ordinarily

inhabits the home (as Helga does) or is related to such a person and is entitled to receive income or capital from the trust at some point. It should be quite simple to insert a clause into the trust agreement giving Helga a small part of the capital of the trust when it is wound up in order to make her a specified beneficiary. If others in the family are specified beneficiaries that would preclude them from designating their own home as their principal residence so that must be avoided. The rules are confusing so make sure you get tax advice if you want to do this.

Tax Benefits

The tax benefits of this entire arrangement are significant. The principal residence exemption will make the ultimate gain on the property tax free. There is a provision in the Income tax Act which provides for the tax free distribution of the property to trust beneficiaries so that is available if needed. No tax is payable by the trust but if the trust pays for any of the upkeep or maintenance on the property that there would be a taxable benefit to Helga. Given Helga's low tax rate that is not a problem. The arrangement also stops some of the future growth in mom and dad's estate and should reduce income taxes on their death. All in all, it's a good tax deal.

Social Assistance

Individuals in Ontario (and most other provinces) receiving social assistance through the Ontario Disability Support Program are not eligible to receive that assistance (housing, cost of living, medical benefits) if their assets and income exceed minimal levels. However, rent free use of a home is not considered to be income so holding a residence for an individual with special needs in a trust is an ideal way to provide housing without a social assistance penalty. When the housing need no longer exists, the home can be transferred out of the trust to other family members or a charity.

Conclusion

So dad's objections have been met. Mom and dad agree to move on this very important part of their estate planning. If they are worried about parting with the $250,000 now, they could put a clause in their wills accomplishing the exact same objectives through a testamentary trust.

The use of a trust to own a principal residence can be extended to situations beyond those discussed above. For example, the same structure (with some modifications) might be used to keep a cottage in the family or provide a home to a person with disabilities and still maintain their eligibility for social assistance as discussed above. *This article was originally published in the Canadian MoneySaver magazine.*

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