

TRUST FUNDS FOR PERSONS WITH DISABILITIES RECEIVING BENEFITS UNDER THE ONTARIO FAMILY BENEFITS ACT

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Introduction: Trusts for Disabled F.B.A. Allowance Recipients

Under the current regulations to the *Family Benefits Act*¹ (F.B.A.), F.B.A. allowance recipients are not penalized when they hold a beneficial interest in certain types of trusts and apply payments from those trusts to disability-related expenses. Neither trust capital nor trust income will be taken into account when calculating eligibility for, or the quantum of, an F.B.A. allowance. In this way, disability-related expenses can be privately funded through a trust arrangement.

This is a major change for the Ontario Ministry of Community and Social Services (M.C.S.S.), which is responsible for administering the F.B.A. For some time, the M.C.S.S. considered all assets held in trust to be liquid assets which usually took the trust beneficiary over the liquid-asset ceiling established in the regulations and made him or her ineligible to receive an F.B.A. allowance.² However, in 1989, two appeal decisions, *Ontario (Minister of Community & Social Services) v. Henson*³ and *Ontario (Director, Income Maintenance Branch) v. Powell*,⁴ established that discretionary trusts are not liquid assets as defined by the F.B.A. regulations.

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¹ R.S.O. 1990, c. F-2.

² The limits vary from about \$2,500 to \$6,000 depending on the allowance recipient's family circumstances.

³ (1989), 36 E.T.R. 192 (Ont. C.A.), affg 28 E.T.R. 121, 26 O.A.C. 332, [1987] O.J. No. 1121 (Q.L.) (Div. Ct.), affg (August 22, 1985, S.A.R.B.), unreported.

⁴ (1989), 38 E.T.R. 205, 36 O.A.C. 310, [1989] O.J. No. 2310 (Q.L.) (Div. Ct.); varg (December 19, 1988, S.A.R.B.) unreported. The Divisional Court found that the income from the trust was caught by the definition of liquid assets. S.A.R.B. had held that neither the capital nor income of the trust was caught by the definition.

It was possible to both hold a beneficial interest in assets within a discretionary trust and receive an F.B.A. allowance.⁵ Subsequently, in 1993, the F.B.A. regulations were amended to include s-s. 1(1)(i), which exempts certain trusts from the definition of liquid assets, and s. 13(2), para. 49, which exempts from income calculations any trust payments applied to disability-related expenses.⁶

The combination of these two exemptions provides an excellent way to privately fund disability-related expenses without negatively affecting the trust beneficiary's F.B.A. allowance. Such disability-related expenses could include day programmes for the mentally handicapped or home renovations to improve accessibility for the physically handicapped. Provided that the expenditures are not reimbursed from some source, the income exemption applies. Given this possibility, some people could choose to forego publicly funded services and programmes available for the disabled, opting instead for private services and programmes paid for through a trust arrangement. This currently occurs in the health care sector when people go outside the public health care system to avoid waiting lists and lengthy delays.

However, the use of private funding to finance disability-related expenses is frustrated by restrictions imposed by the regulations. In short, the trust in which the F.B.A. allowance recipient has a beneficial interest, and from which payments are received, must have a "testamentary aspect," the term used in this article. The regulations distinguish trusts according to whether or not the beneficial interest in the assets held in trust was derived from an inheritance, not according to whether the trust itself is testamentary or *inter vivos*. The F.B.A. recipient can establish an *inter vivos* trust using funds from an inheritance,⁷ or the donor can establish the trust through a testamentary document.⁸ There must have been a death.

Three possible explanations of why the s. 13(2), para. 49 disability-related-expenses income exemption is limited to testamentary-aspect trusts are:

⁵ Only the *Henson* trust was fully discretionary; the *Powell* trust was not discretionary with respect to the trust income; cf. footnote 12, *infra*, for a discussion of the *Henson* trust. Further in this article, we refer only to *Henson*-worded trusts.

⁶ Regulations made under the *Family Benefits Act*, R.R.O. 1990, Reg. 366, as amended by O. Reg. 436/93, further amended O. Reg. 196/94 the (F.B.A. regs.).

⁷ An M.C.S.S. fact sheet, "Trust Funds for People with Disabilities Receiving Family Benefits" (Ontario: Queen's Printer, undated) at p. 2, notes that the following will qualify as derived from an inheritance: funds left on an intestacy and funds received when the person is beneficiary of a life insurance policy, R.R.S.P., G.I.C. and similar instruments.

⁸ This is the interpretation used in the M.C.S.S. fact sheet, *ibid.*: "The funds received [from inheritance] must have already been or will be placed in trust for the benefit of the client."

- (i) the *Henson* and *Powell* decisions, on whose heels followed the s. 1(1)(i) and 13(2), para. 49 exemptions, both dealt with testamentary trusts;
- (ii) the *Income Tax Act*⁹ discriminates against *inter vivos* trusts; and
- (iii) only deceased friends and relatives need a trust vehicle to make financial contributions to an allowance recipient.

On closer examination, none of these satisfactorily explain why this limitation was adopted.

In this article, we consider more closely the ss. 1(1)(i) and 13(2), para. 49 liquid-asset and income exemptions, the importance of the s. 13(2), para. 49 exemption relative to other income exemptions and whether the M.C.S.S. is justified in restricting the s. 13(2), para. 49 exemption to testamentary-asset trusts.

The Disability-Related-Expenses Income Exemption

Section 13(2), para. 49 Income Exemption

Section 13 of the regulations defines income very broadly as including "all payments of any nature or kind whatsoever". Any income received by an F.B.A. allowance recipient will lower his or her allowance dollar for dollar.¹⁰ A substantial exemption from these calculations is provided by s-s. 13(2), para. 49 of the regulations.¹¹ This subsection exempts any payment¹² received from a trust of which the F.B.A. allowance recipient is beneficiary, to the extent that the payment is applied to disability-related expenses

⁹ R.S.C. 1985, c. 1 (5th Supp.).

¹⁰ F.B.A. regs., s. 11:

11. The amount of an allowance shall be equal to the budgetary requirements of an applicant or recipient determined in accordance with section 12 or 31, as the case may be, and section 41, minus the income of the applicant or recipient in accordance with section 13.

¹¹ F.B.A. regs., s. 13(2), para. 49, exempts:

... any payment received by an applicant or recipient by reason of his or her beneficial interest in assets held in trust if the beneficial interest is derived from an inheritance and either exempt as a liquid asset or not a liquid asset and if the payment is applied to,

- i. expenses for aids, assistive devices, health needs, renovations to the principal residence of the applicant or recipient, or services that,
 - A. are related to the applicant's or recipient's disability, and
 - B. are not and will not be otherwise reimbursed,
- ii. education or training expenses that,
 - A. are incurred as a result of the applicant's or recipient's disability, and
 - B. are not and will not be otherwise reimbursed, or
- iii. other disability related expenses up to an annual maximum of \$3,300.

¹² Payments can be made up of any combination of trust income and capital.

and not reimbursed. However, use of the exemption is limited. First, the beneficial interest in the trust capital must be derived from an inheritance; *i.e.*, the trust must have a testamentary aspect. Second, the beneficial interest in the trust must be excluded from liquid-asset calculations, *i.e.*, the trust must be either exempt from liquid-asset calculations by s. 1(1)(i) or not be a liquid asset at all because it is a *Henson*-worded trust.¹³ In short, the s. 13(2), para. 49 exemption applies only if the trust has a testamentary aspect and the beneficial interest in the trust assets is not taken into account in the liquid-asset calculations.

Trusts Which can Take Advantage of the s. 13(2), para. 49 Income Exemption

As noted above, to take advantage of the s. 13(2), para. 49 income exemption, a trust must either qualify for the s. 1(1)(i) liquid-asset exemption or be a testamentary *Henson*-worded trust.

To qualify for the s. 1(1)(i) liquid-asset exemption,¹⁴ a trust must

¹³ A *Henson*-worded trust is not a liquid asset because the trust is fully discretionary and the beneficial interest is not "available to be used for maintenance" as required by the definition of liquid assets in the regulations. The trustee of the *Henson* trust had a bare discretion over whether to make any payment to the beneficiary, and a fiduciary duty not to make payments if that would lower the beneficiary's income from social assistance. The beneficiary had no way to compel the trustee to make payments. The Social Assistance Review Board, the Ontario Divisional Court and the Ontario Court of Appeal all found that the beneficial interest in assets held in the discretionary trust was not available for maintenance. The Divisional Court in *Henson* went so far as to comment that "the beneficiary does not have a beneficial interest as that term is used in the definition of liquid assets," *Henson*, *supra* footnote 3.

When s. 13(2), para. 49 was introduced in 1993 by O. Reg. 436/93, s. 5(5), it did not apply to *Henson*-worded trusts because it contained the words "and available to be used for maintenance". That phrase was struck out in 1994 by O. Reg. 196/94, s. 2(2), so that the subsection would encompass *Henson*-worded trusts. See the M.C.S.S. fact sheet, *supra* footnote 7, at p. 4, for confirmation that testamentary *Henson*-worded trusts can use the s. 13(2), para. 49 exemption: "The income exemptions for disability-related expenses will be allowed on 'Henson trusts'. This has been clarified by an amendment to s. 13(2)49 made in March 1994 removing the words 'and available for maintenance' which had been included in the August 1993 provision and which had the effect of limiting the availability of the income exemption."

¹⁴ F.B.A. regs., s. 1(1)(i):

(i) for the purposes of determining the eligibility of an applicant or recipient for an allowance under clause 7(1)(c) of the Act or under subsection 2(5) of this Regulation and computing the amount of the allowance, the applicant's or recipient's beneficial interest in assets held in trust and available to be used for maintenance, if,

(i) the capital of the trust is derived from an inheritance,

(ii) the value of the capital of the trust does not exceed,

(A) \$65,000, or

(B) such greater amount as the Director may approve if the applicant or recipient provides documentation that demonstrates to the satisfaction of the Director

comply with three conditions: (i) the beneficial interest in the trust capital must be available for maintenance, (ii) the capital of the trust must be derived from an inheritance and (iii) the value of the trust capital must be less than \$65,000 or such amount as approved by the Director appointed under the F.B.A. The first condition excludes *Henson*-worded trusts since they are characteristically not available to be used for maintenance.¹⁵ The second condition restricts the exemption to trusts with a testamentary aspect. The third condition places a ceiling on the amount of capital that can be held in an exempt trust. As well, if an F.B.A. allowance recipient holds a beneficial interest in more than one trust, this ceiling applies to the aggregate of the capital of these trusts.

Trust arrangements are limited only by the imagination of the settlor. However, if the settlor is also the F.B.A. allowance recipient who is using inherited funds to establish an exempt trust, he or she must consider s. 8 of the F.B.A. regulations, which obliges an allowance recipient to make reasonable efforts to pursue outside sources of income.¹⁶ The section creates an expectation that the settlor will arrange to have all trust income paid out, whether or not it can be applied to disability-related expenses. The M.C.S.S. takes the position that: "While an individual may be permitted to place funds in a trust, he or she will be expected to have the income paid out and only to the extent that it is spent on disability related items will it be exempt as income. If it is not paid out, a deemed amount will be included and the allowance reduced accordingly."¹⁷

that the available capital of the trust and the estimated income from the trust are required to meet the applicant's or recipient's lifetime expenses referred to in paragraph 49 of subsection 13(2), and

- (iii) the sum of the values of the original capital of all trusts in the assets of which the applicant or recipient has or has had a beneficial interest that has qualified as an exempt liquid asset on or after August 1, 1993 while he or she has been in receipt of an allowance under clause 7(1)(c) of the Act or under subsection 2(5) of this Regulation, has not exceeded \$65,000 or such greater amount approved by the Director under sub-clause (ii)(B);

¹⁵ *Cf.*, *supra* footnote 13.

¹⁶ FBA regs, s. 8:

8. Where the Director is not satisfied that an applicant or recipient is making reasonable efforts to obtain compensation or realize any financial resource that the applicant, recipient, or a beneficiary *included or to be included in the recipient's allowance, may be entitled to or eligible for* the Director may determine that the applicant, recipient or beneficiary is not eligible for a benefit or the Director may reduce the amount of an allowance granted by the amount of the compensation, contribution or financial resource, as the case may be, that in the Director's opinion is available to the applicant, recipient or beneficiary. [Emphasis added.]

¹⁷ M.C.S.S. Fact Sheet, *supra* footnote 7, at p. 4.

The second type of trust eligible for the s. 13(2), para. 49 income exemption is a testamentary *Henson*-worded trust. It fulfils both requirements for the income exemption: it has a testamentary aspect and the beneficial interest in the trust assets is not taken into account in the liquid-asset calculations.

Relative Importance of the Disability-Related-Expenses Income Exemption

If a trust is not eligible to use the s. 13(2), para. 49 income exemption, it will have to rely on other income exemptions provided in the regulations. Only two other income exemptions can apply to trust payments, and they are small, relative to the disability-related-expenses exemption. These exemptions are casual gifts of small value¹⁸ — were the trustee to buy gifts for the trust beneficiary — and casual payments of small value.¹⁹

These two exemptions are not substantial. First, the gift or payment must be of small value.²⁰ Second, it must be given irregularly. If given regularly, it will likely taken into account in the income calculations.

The disability-related-expenses exemption, on the other hand, can be very substantial. First, there is no limit on the amount that can be spent on prescribed disability-related expenses. An M.C.S.S. fact sheet lists even the following as prescribed expenses: “a modified vehicle, expenditures towards an accessible new residence, education and training expenses which are required to improve employability . . . attendant care, homemaking services, meals on wheels, home/yard maintenance and cost of attending a day program.”²¹ Second, these payments can occur regularly. Cumulatively, these expenditures can amount to a large annual income exemption. To use the s. 13(2), para. 49 exemption, the F.B.A. allowance recipient or his trustee must file an annual income and expense transaction report with the F.B.A. Director.²²

¹⁸ F.B.A. regs., s. 13(2), para. 27 exempting “casual gifts of small value”.

¹⁹ F.B.A. regs., s. 13(2), para. 28 exempting “casual payments of small value”.

²⁰ However, the M.C.S.S. fact sheet, *supra* footnote 7, at p. 5, lists even furniture as a gift eligible for this exemption.

²¹ *Ibid.*

²² F.B.A. regs., s. 13(13) (as am. O. Reg. 436/93, s. 5(7):

13(13) The exemption from income under paragraph 49 of subsection (2) applies if the applicant or recipient files an annual report in a form satisfactory to the Director documenting all income and expense transactions relating to the assets held in trust for the year in respect of which the report is filed.

As noted above, only trusts with a testamentary aspect can use the disability-related-expenses income exemption. Trusts established by a living friend or relative, or by the F.B.A. allowance recipient using funds received from a living donor, cannot. Any payments from the trust which do not fit either of the exemptions for casual gifts or payments of small value would be included in the income calculations and would lower the size of the recipient's F.B.A. allowance dollar for dollar.

Favourable Treatment Given to Testamentary-Aspect Trusts is Unwarranted

Under the current regulations, a death must occur in order that a disabled F.B.A. allowance recipient may take advantage of the s. 13(2), para. 49 income exemption. There are three possible explanations for this:

The Henson and Powell trusts were testamentary

Both the *Henson* and *Powell* trusts were testamentary trusts established for adult children receiving F.B.A. allowances as disabled adults. However, the testamentary nature of the trusts was irrelevant to the courts which held that a beneficial interest in a discretionary trust is not available to be used for maintenance. The *Henson* and *Powell* court decisions were based squarely on analyses of the trust declarations and the beneficiaries' inability to compel the trustees to violate the trust declarations. The testamentary nature of the trusts was not a factor for the courts which in each case upheld the clear, unambiguous trust declarations.²³ Other courts

²³ The *Henson* trust declaration read (at pp. 123-4 E.T.R. (Div. Ct.):

To pay so much of the income therefrom, or the whole of the income therefrom, together with so much of the capital thereof to or for the benefit of my daughter AUDREY JOAN HENSON as my Trustees shall in the exercise of their absolute and unfettered discretion consider advisable from time to time. Any income not so paid in any year shall be accumulated by my Trustees and added to the capital of the residue of my estate, provided, however, that if it becomes unlawful for my Trustees to continue such accumulation of income, then the income not so paid in any year to or for the benefit of my said daughter shall be paid to the Guelph and District Association for the Mentally Retarded Incorporated. The residue of my estate and the income therefrom shall not vest in my said daughter and the only interest she shall have therein shall be the payments actually made to her, or on her behalf, and received by her or for her benefit therefrom. Without in any way binding the discretion of my Trustees, it is my wish that in exercising their discretion in accordance with the provisions of this paragraph, my Trustees take account of and in so far as they may consider advisable take such steps as will maximize the benefits which my said daughter would receive from other sources if payments from the income

would not contradict that reasoning if faced with an identical trust declaration but an *inter vivos* trust.

The *Henson* and *Powell* decisions are not a satisfactory explanation for why the F.B.A. regulations restrict the s. 13(2), para. 49 disability-related-expenses income exemption to trusts with a testamentary aspect.

The Income Tax Act Discriminates Against Inter Vivos Trusts

The *Income Tax Act* (I.T.A.) does discriminate against *inter vivos* trusts to a limited extent. All income of an *inter vivos* trust allowed to accumulate in the trust will be taxed at the highest federal rate, whereas the accumulating income of a testamentary trust will be taxed on a progressive basis. However, this discriminatory tax treatment is easily avoided. There will be no discrimination if the income from an *inter vivos* trust is paid out to the beneficiary, or if there has been a preferred beneficiary election.

Section 122(1) of the I.T.A. imposes the maximum federal tax rate on the accumulating income of an *inter vivos* trust. But if the income flows through the trust, it will be taxed in the hands of the trust beneficiary as personal income.²⁴ Section 104(14) of the I.T.A. permits a preferred beneficiary²⁵ to pay tax on all or part of the accumulating trust income. The income of the *inter vivos* trust will be taxed as though in the hands of the beneficiary while actually accumulating in the trust. This provision was recently amended by the 1995 federal budget: it is now available only to mentally or physically disabled preferred beneficiaries.²⁶

While the I.T.A. does discriminate against *inter vivos* trusts, in practice, there need not be any difference in the tax treatment of *inter vivos* or testamentary trusts, especially where the beneficiary is disabled. Discrimination in the I.T.A. against *inter vivos* trusts

and capital of the residue of my estate were not paid to her for her own benefit, or if such payments were limited to an amount or time. In order to maximize such benefits, I specifically authorize my Trustees to make payments varying in amounts and at such time, or times, as my Trustees in the exercise of their absolute discretion may consider in the best interest of my said daughter.

²⁴ Note, however, that there will be attribution of trust income back to the settlor/donor if the trust beneficiary is the settlor's spouse or a "non-arms-length minor," *i.e.*, a minor child or niece or nephew. I.T.A., s. 74.1(1) and (2)

²⁵ "Preferred beneficiary" is defined in s. 108(1) of the I.T.A. as the settlor of the trust, spouse and former spouse of the settlor, children, grandchildren and great-grandchildren of the settlor or settlor's spouse.

²⁶ Department of Finance, *Budget in Brief* (Ottawa: Canada Communications Group, 1995), at p. 18.

