

Registered Disability Savings Plans (RDSPs)

As announced in the Canadian government's 2007 Federal Budget, RDSPs could begin accepting contributions for qualifying disabled individuals as of the beginning of 2008. While there are some similarities with other registered savings vehicles, these plans have many unique characteristics and novel tax features that require a thorough review before determining how best to make use of them.

Unique needs of disabled families

This tax bulletin reviews the recently introduced Registered Disability Savings Plan. For more general information on disability needs planning, ask for our Tax & Estate Info Page on *Disability tax and estate planning*.

Registered Disability Savings Plan (RDSP) overview

An RDSP is a registered investment plan under the *Income Tax Act (Canada)* intended to encourage long-term savings by and for persons with disabilities. The core plan is modelled after the Registered Education Savings Plan (RESP) and its associated grant and bond incentive programs, but there are some significant differences.

As with RESPs, money contributed to an RDSP is not tax-deductible and government grants and bonds are deposited directly to the plan tax-free. Grants can be as much as 300% of personal contributions, and bonds may be obtained without making any personal contributions so long as an income test is satisfied.

Earnings and growth on all deposits accrue tax-free. The beneficiary is the only person entitled to any payments. He or she is the person taxed on those

payments, with the taxable amount reduced by the proportion of personal contributions. As well, there are absolutely no restrictions placed on the use of RDSP payments so long as they are received by the beneficiary or applied for his or her benefit.

Who may benefit from an RDSP?

In order to commence a disability savings plan, the beneficiary of the plan must qualify for the disability tax credit (DTC) in the year of establishment. A person qualifies for the DTC where that person:

- is a Canadian resident,
- has one or more severe and prolonged impairments in physical or mental functions, and
- has obtained certification of the qualifying condition(s) (on the appropriate forms prescribed under tax regulations) from a medical practitioner.

So long as the person continues to be a DTC-eligible individual, the plan may continue to receive deposits, shelter growth and earnings from taxation and eventually distribute the accumulated funds to the plan beneficiary.

Designation of a plan beneficiary is irrevocable, and the beneficiary's right to receive plan payments cannot be assigned or surrendered.



Administrative requirements

Establishing an RDSP

As a starting point, all RDSP issuers must execute a written compliance agreement with the Minister of Human Resources and Social Development, and deposit an approved specimen plan with the Minister of National Revenue.

A disability savings plan may then be established by agreement between the beneficiary and a qualified RDSP issuer. Alternatively, a “qualifying person” may act on behalf of the beneficiary to establish the plan. The definition of “qualifying person” is limited to:

- a legal parent of the beneficiary, if the beneficiary is a minor, or
- if the beneficiary is not contractually competent (whether because of age or otherwise) to enter into such an arrangement, a guardian, tutor or curator of the beneficiary under the laws of the province in which the beneficiary resides, or a public department, agency or institution that maintains the beneficiary.

This means that, if the beneficiary is of the age of majority and contractually competent, no one other than the beneficiary can enter into the arrangement with the issuer. Only if the beneficiary is a minor, or is not otherwise contractually competent, can anyone other than the beneficiary enter into the arrangement.

In addition to an issuer’s administrative requirements, a Social Insurance Number must be provided for the beneficiary and for each of the “holders” (defined in the next paragraph) entering into the agreement before a registered plan may be set up.

Ongoing management

Once a disability savings plan is established, each person or organization contracting with the issuer is a “holder” of the plan. In practice, the holders have principal decision-making authority with respect to the plan, which could include, for example, directing investments and the amount and timing of payments.

While the funds in a plan may be transferred from one issuer to another, the transferor plan must be terminated in order for the receiving plan to become active. In effect, there is an absolute one-to-one relationship between a plan and a beneficiary as:

- there can be only one beneficiary for a given plan, and
- at any given time, there can be only one plan for a particular beneficiary.

Given this tight restriction, it is important to know that a beneficiary does not automatically become a holder upon reaching the age of majority. There is, however, an explicit provision requiring that the plan be operated exclusively for the benefit of the beneficiary, with the legislative intention that the beneficiary can use this as a legal basis to acquire control from the existing holders, if necessary.

Contributions

Allowable contributions

Contributions to a plan are not tax-deductible no matter who the contributor is, nor do they ever result in an income inclusion for the plan, the beneficiary or anyone else.

So long as accumulated contributions have not exceeded the lifetime maximum of \$200,000, a contribution can be made in a given year provided that the beneficiary is:

- a DTC-eligible individual,
- age 59 or younger on December 31 of the year of contribution, and
- a Canadian resident.

While contributions may not be made during the time that a beneficiary is not a Canadian resident, that plan may otherwise continue in-force for a non-resident beneficiary.

There is no annual contribution limit, but plan holders should carefully consider current and future availability of grants and bonds before deciding how best to fund a plan.

Allowable contributors

Only holders are entitled to make contributions to a plan, though others may do so with the written consent of the holders. Again, this provides a regulated mechanism for holders to manage access to potential grants and bonds.

Unlike RESPs where the subscriber is entitled to a tax-free return of his or her deposits, once RDSP contributions have been committed into a plan, those funds can only come out of the plan via the rules for payments to or for the beneficiary. In other words, neither a holder nor a contributor has any property interest in any part of an RDSP.

Managing contributions strategically

Communication is extremely important between holders and potential contributors, particularly in will and estate planning. For example, a well-meaning grandparent who wishes to make a large lump-sum contribution to a grandchild's RDSP may put a plan holder in a dilemma as to whether to accept the contribution and lose future grants or decline the inheritance to preserve the plan's integrity.

What is the Canada Disability Savings Grant (CDSG)?

The CDSG encourages the use of an RDSP by matching up to 300% of annual contributions made into a plan to a lifetime maximum of \$70,000.

Qualification for a grant is determined by measuring “net family income” (defined below) against a threshold level, being \$75,770 in 2008.

Where net family income is below the threshold level, the government will provide:

- \$3 for every \$1 on the first \$500 of contributions
- \$2 for every \$1 on the next \$1,000 of contributions

Where net family income exceeds the threshold, the government will provide:

- \$1 for every \$1 on the first \$1,000 of contributions

“Net family income” is determined by considering the age and spousal status of the beneficiary:

- For a beneficiary under 19, it is the combined net income of that person’s parents
- For a beneficiary 19 or older, generally, it is that person’s own net income, whether or not the beneficiary continues to live with his or her parents
- For a beneficiary 19 or older cohabiting with a spouse or common-law partner, it is the combined net income of those two persons

Grants are available for contributions made up until the end of the year in which the beneficiary turns 49.

What is the Canada Disability Savings Bond (CDSB)?

The CDSB is targeted to better support low- and modest-income families, children in care and adults without family support.

CDSB entitlement is not dependent on contributions. It provides up to \$1,000 per year to RDSPs up to a maximum lifetime limit of \$20,000 per disabled beneficiary.

The maximum annual amount of CDSB assistance of \$1,000 will be paid to an RDSP where family net income does not exceed the lower-income threshold. The CDSB is decreased gradually for family net income up to an upper-income threshold. These income thresholds were originally stated in 2007 dollars, with indexing to be applied in following years. For 2008, the lower threshold is \$21,229 and the upper threshold is \$37,884.

Federal contributions summary table

Finance Canada has estimated that as many as 180,000 beneficiaries will qualify for CDSG support, and of those, as many as 105,000 will also qualify for CDSB support. In addition to these grants, the federal government has suggested that provincial governments may also choose to offer grants of some sort, though no such programs have yet been announced. Maximum amount of federal assistance available:

Family income thresholds (indexed)	Up to \$21,229	\$21,230–\$37,884	\$37,885–\$75,770	Over \$75,770
CDSG (\$70,000 lifetime max.)				
3 to 1 (300%) on first \$500	\$ 1,500	\$ 1,500	\$ 1,500	\$ –
2 to 1 (200%) on next \$1,000	2,000	2,000	2,000	–
1 to 1 (100%) on first \$1,000	–	–	–	1,000
CDSB (\$20,000 lifetime max.)				
No personal contribution required	1,000	500*	–	–
Total assistance	\$ 4,500	\$ 4,000	\$ 3,500	\$ 1,000

* This is the average amount of CDSB, assuming an even distribution of families over the income range.

Payments

Purpose

Apart from some age and liquidity protections discussed below, there are no restrictions on the timing or amount of a disability assistance payment, or on the use to which such a payment is put.

Timing and amount

There are two types of RDSP payments:

- Lifetime disability assistance payments
- Disability assistance payments

Lifetime disability assistance payments or LDAPs must commence no later than the year in which the

beneficiary attains 60 years of age. The total of all LDAP payments in a calendar year is subject to a maximum as follows:

$$\frac{\text{Fair market value}}{(\text{Greater of age 80 or age}) + 3 - \text{age}}$$

This calculation is revisited each year, and for a beneficiary beyond expectancy age or with reduced expectancy, a greater payment is possible.

Whether a plan is allowed to make the more general “disability assistance payment” or DAP must be specified in the particular plan documentation. Such payments are not subject to any life expectancy constraint.

Minimums and maximums

Further constraints may apply to the amount of payments depending on how much government assistance has been received in proportion to contributions. In a given calendar year, if the total of all past bonds and grants paid exceeds the total of all past contributions made, then:

- The maximum annual payment cannot exceed the LDAP calculation
- If the beneficiary is 60 or over, the LDAP payment is also the minimum payment
- For a beneficiary with a medically certified life expectancy less than 5 years, these rules may be relaxed

Assistance holdback amount

The potential value of government contributions could be quite significant relative to personal contributions. To assure that these support dollars are protected should the plan become deregistered, a holdback calculation assures that there is always a sufficient balance to pay back the government.

In essence, the holdback calculation keeps a running tally of all grants and bonds in the ten years prior to any of the following events:

- The RDSP is terminated by the holder
- The RDSP is found to be non-compliant
- A disability assistance payment is made
- The beneficiary ceases to be DTC-eligible
- The beneficiary dies

The occurrence of any of these events triggers repayment of the full assistance holdback amount, though earnings and growth on that amount need not be repaid. Thankfully for plan holders, the responsibility for tracking this holdback amount falls on the plan issuer.

Entitlement and structure

While the RDSP program is generally modelled after the well-established RESP program, one of the most significant departures from that program is the manner by which accumulated RDSP funds may be accessed.

Guarding against unexpected plan deregistration

Deregistration can occur if the plan fails to comply with investment and reporting regulations, but generally, the expectation would be that it would only occur if the beneficiary is no longer a DTC-eligible individual. During consultations subsequent to the RDSP announcement in the 2007 Budget, concern was expressed that a beneficiary might decline the DTC in order to force the collapse and payout of an RDSP. In response, the 2008 Budget included an amendment to protect against such a premature payout so long as the beneficiary remained factually entitled to the DTC, even if it was not actually received.

In an RESP, a subscriber may obtain return of his or her contributions, along with any growth in the plan (subject to penalty tax). By comparison, other than plan-to-plan transfers and repayment of government assistance, the beneficiary is the only person with a right to payments from the RDSP.

Furthermore, one cannot separately access the non-taxable contributions: An RDSP payment is a blended return of contributions (non-taxable) and grants, bonds and earnings on all deposits (taxable). Each payment dollar is therefore partially taxable, with the non-taxable component being the proportion that personal contributions are to the total value of the plan's assets at the time of payment. This is a similar effect as in a systematic withdrawal plan (SWP), except that the income component here is fully taxable whereas SWP growth is generally only one-half taxable as a capital gain. (For more information, ask for our Tax & Estate Info Page, *Systematic Withdrawal Plans*.)

Effect on income-tested government supports

While the beneficiary is the taxable entity with respect to the payments, amendments have been made to federal legislation to neutralize the effect this would otherwise have on income-tested supports and tax credits. In particular, RDSP income will not affect entitlement to the GST credit nor to the Canada Child Tax Benefit.

The effectiveness of the RDSP program will hinge on how well it dovetails with support programs administered provincially. To date, British Columbia and Newfoundland and Labrador have explicitly stated that RDSP assets and income will not affect provincial income-tested disability entitlements. Quebec has also stated its intention to exempt RDSP assets and income.

So how much can be accumulated?

Let's assume that parents start making annual RDSP contributions when they are age 40 and their child is age 10, for the next 25 years. Once the plan beneficiary is over age 18, it is assumed that the beneficiary qualifies for the maximum CDSG matching rates and the full CDSB based on his or her family income.

Family income of parents	\$ 20,000	\$ 40,000	\$ 80,000
Annual RDSP contribution	500	1,000	1,500
Total contributions over 25 years	12,500	25,000	37,500
Assets available for payments at 25 years	138,000	183,000	184,000
Accumulation <i>including holdback</i>	158,000	218,000	229,000

In each case, the accumulated RDSP value is actually 20–35% more than the amount available for payments. The difference is the repayable holdback amount for the most recent 10 years of grants and bonds. If the family chooses to delay disability payments, the proportion of funds available for payments will in fact rise as the 10-year holdback period rolls past the last grant and bond payment dates.

While the actual calculations are based on making full contribution at the beginning of the year, this might be viewed as a weekly cost of approximately \$10, \$20 or \$30 for the respective families.

Conclusion

The RDSP structure presents disabled persons and their families with a tax-effective means for long-term savings. Coupled with generous support from the CDSG and CDSB programs, these plans can be the central feature of the income and wealth management plan for disabled beneficiaries.

For more information about this topic, contact your advisor, call us at **1.800.874.6275** or visit our website at www.aimtrimark.com.

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