Planning with RDSPs

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People with disabilities and their families have an important tool in their planning toolkit: the Registered Disability Savings Plan (RDSP).

An RDSP allows the plan holder to save up to $200,000 in a tax-deferred account on behalf of a beneficiary who is 59 years of age or under and qualifies for the disability tax credit (DTC).

The DTC is a credit available to an individual with a severe and prolonged physical or mental disability. To qualify for the DTC, a medical doctor or other medical specialist must certify Form T2201, "Disability Tax Credit Certificate," which must then be approved by the Canada Revenue Agency.

The RDSP is partly modeled after the Registered Education Savings Plan (RESP) and its associated grant and bond incentive programs. As with RESPs, money contributed to an RDSP is not tax deductible, there are no annual contribution limits and earnings and growth on all contributions accrue tax-deferred.

Canada Disability Savings Grants & Bonds

For many individuals and their families, the generous potential assistance available to RDSPs from the Government of Canada may be the primary motivation to set one up.

This assistance comes in two forms: an income-tested matching grant, known as the Canada Disability Savings Grant (CDSG), and the income-tested bond, known as the Canada Disability Savings Bond (CDSB).

CDSGs and CDSBs can be paid into an RDSP up until the end of the year in which the beneficiary turns 49.

The amount of the CDSG and CDSB that can be received is based on "family income." Whose family income? That depends on the age of the beneficiary.

If the RDSP beneficiary is under 19, it's the family income of the beneficiary's parents or guardian. Beyond age 18, however, it's the beneficiary's own family income that is

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relevant. If the beneficiary is under the care of an agency receiving an amount under the Children's Special Allowances Act (Canada), then family income is not an issue and the beneficiary qualifies for the highest amount of government assistance.

If annual family income is less than or equal to $83,088, the CDSGs are equal to 300% on the first $500 of contributions and 200% on the next $1,000 of contributions. So, by contributing $1,500, the RDSP could collect CDSGs of $3,500 (the maximum annual amount).

If annual family net income is over $83,088, the CDSG is limited to 100% of the first $1,000 of annual contributions.

The CDSB is meant for lower-income families and is equal to $1,000 per year when annual family income is less than or equal to $24,183. No contributions are required to receive the CDSB and it is phased out, pro-rata, based on annual family income between $24,183 and $41,544.

The maximum amount of CDSGs collectible during the beneficiary's lifetime is $70,000 and the maximum available in CDSBs is $20,000.

2011 marks the first time that retroactive CDSGs and CDSBs can be collected based on new contributions.

As a result of the change, when an RDSP is opened, CDSGs and CDSBs will ultimately be paid on unused entitlements for the preceding 10 years (but no earlier than 2008) up to an annual maximum of $10,500 and $10,000, respectively. The CDSG unused entitlement is applied first to the highest available matching rate, followed by any grant entitlement at lower rates. Both CDSGs and CDSBs will be based on the beneficiary's family income in those particular years.

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For example, Josh has a disability and minimal income but has not yet opened an RDSP. For each of 2008, 2009, 2010 and 2011, Josh accumulated $500 in CDSG entitlements at a 300% matching rate ($500 x 4 = $2,000) and $1,000 in CDSG entitlements at a 200% matching rate ($1,000 x 4 = $4,000). Also, he earned CDSB entitlements of $1,000 for each of those years ($1,000 x 4 = $4,000).

If Josh opens an RDSP in 2011 with only a $2,000 contribution, he can collect $10,000 of government funds. First, he receives $4,000 of CDSBs, amounting to $1,000 for each of 2008, 2009, 2010 and 2011. He will also receive $6,000 of CDSGs based on his $2,000 contribution, representing a 300% match of his four annual accumulated $500 CDSG entitlements.

Josh will still have $4,000 of CDSG entitlements at 200% to be carried forward to collect in future years if and when he is able to make sufficient contributions.

If you're thinking you can simply open up the account for a few years, collect some government CDSGs and CDSBs, and then withdraw all the money, think again. There is a special holdback rule that if anything is withdrawn from the RDSP, even only one dollar, all CDSGs and CDSBs paid into an RDSP in the preceding ten years must be repaid to the government. As a result, the plan issuer must prevent payments that would cause the value of plan assets to go below the government assistance holdback amount.

The rule was put into place to ensure that RDSPs are used to promote "long-term savings" for a disabled person, as well as to prevent CDSGs and CDSBs from being essentially "recycled" through withdrawals to obtain future years' matching grants.

The holdback rule also requires the ten-year repayment should the beneficiary die or no longer be eligible to claim the DTC.

If the specific RDSP permits, withdrawals can be paid out at any time, but in any event, must begin no later than the end of the year the beneficiary turns 60. There are maximum limits as to how much can be paid out, and in cases where the total CDSGs and CDSBs exceed the amount privately contributed, there is a minimum payout requirement as well.

The payments must be made to the beneficiary, if he or she is alive, and there is no restriction on how the payments must be used.

In the event of the beneficiary's death, the RDSP assets must be paid out to the deceased beneficiary's estate, less any assistance holdback amount that must be repaid to the government, by the end of the year following the year of the beneficiary's death. This means the RDSP assets will pass in accordance with the beneficiary's will, or if there is no will, on an intestacy.

RRSP/RRIF/RPP proceeds rollover upon death to RDSP.

Another opportunity for establishing a new RDSP or contributing to an existing RDSP will come into effect on July 1, 2011. Effective July 1, 2011, a rollover of proceeds of a deceased individual's RRSP can be made to the RDSP of the deceased individual's financially dependent infirm child or grandchild. These new rules will also apply to amounts contributed to an RDSP using registered retirement income fund (RRIF) proceeds and certain lump-sum amounts paid from registered pension plans (RPP).

If the RRSP/RRIF annuitant or RPP member died after 2007 and but before 2011, special transitional rules effective July 1, 2011 allow a rollover contribution of the deceased's plan proceeds to be made to the RDSP of a financially dependent infirm child or grandchild of the deceased, provided the contribution is made after June 30, 2011 but before 2012.

Effect on provincial disability programs and benefits

Many government benefits, at both the federal and provincial level, are either income or asset-tested, such that any income earned or assets accumulated over certain government-determined thresholds either disqualify or significantly reduce the amount of government assistance.

When the RDSPs were first announced, the federal government took the lead to ensure that assets in an RDSP, when paid to the beneficiary, would not reduce the beneficiary's entitlement to federal income-tested benefits that are delivered through the tax system, such as the GST/HST credit or the Child Tax Benefit. In addition, RDSP payments to the beneficiary would neither reduce Old Age Security benefits nor Employment Insurance benefits.

All provinces and territories also provide various levels of income support for disabled persons, which are means-tested. At the time of writing, nearly all provinces and territories have announced either a full or partial exemption of RDSP assets and withdrawals from asset or income-tested provincial disability benefits.

RDSPs vs. trusts

Until the advent of the RDSP, most planning for persons with disabilities focused on the use of trusts. Specifically, a fully discretionary trust is often used to protect the assets, including an inheritance, on behalf of the beneficiary and to preserve the beneficiary's rights to collect asset-tested

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government benefits and entitlements.

Since the trust is fully discretionary and there is no direct entitlement of the beneficiary to the trust's assets, the general rule in most provinces is that funds in these trusts, set up either during the donor's lifetime or on the donor's death, can be provided for a beneficiary, without affecting the beneficiary's entitlement to provincial government benefits.

Clearly the ability to collect the CDSGs and CDSBs will be a major factor in the decision to use an RDSP as opposed to a discretionary trust, assuming a contributor's funds are not unlimited. In addition, the costs to set up and maintain the trust (annual trustee fees, tax return filing fees, etc.) may reduce its ultimate benefit unless significant funds are available to settle the trust. However, funds contributed to an RDSP must be paid to the beneficiary or the beneficiary's estate. With an RDSP, there is no option to "sprinkle" assets among other family members while the beneficiary is alive or when the beneficiary dies. A trust likely affords more flexibility in this regard.

For wealthier parents, the RDSP will likely be used in conjunction with the discretionary trust to provide for a disabled child. For people with disabilities who want to plan for their future, the RDSP can offer them another means to help secure their retirement.

As with all planning strategies, you should seek the advice of a qualified financial advisor or tax advisor to discuss how RDSPs can form part of your overall plan.

For more information

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