



SPECIAL NEEDS ALERT

SPECIAL NEEDS ALERT is a commentary on topics of current interest – usually topics relating to planning for special needs individuals and changes to current tax and social assistance legislation. Professional advice should be obtained before acting on any of this information. ed.8/10

REGISTERED DISABILITY SAVINGS PLAN INVALUABLE SAVINGS OPPORTUNITY

Registered Disability Savings Plans (RDSPs) first became available in 2008. They still have a low profile and from our experience many people do not really appreciate the financial benefits that can be derived from RDSPs for a family member with a disability. Families really should be encouraged to take a look at them. Total family participation is important because of the interaction between RDSPs and provincial social support programs.

RDSPs

RDSPs can be opened for any individual under age 60 who qualifies for the Disability Tax Credit under the Income Tax Act, is a resident of Canada and has a Social Insurance Number. Contributors to a RDSP can be made by the Plan Holder or anyone approved in writing by the Plan Holder. The disabled person (beneficiary) ultimately must receive all of the RDSP funds and no amounts can be returned to contributors or others.

This **TAX ALERT** deals only briefly with the technical rules governing RDSPs. Much has been written on that and we can provide a detailed Power Point presentation for those who are interested. What this *Alert* wants to show is the RDSP ability to significantly improve the financial well being of a loved one with a disability as compared to simply investing. Bear in mind that if day to day financial needs of a person with disabilities are say \$20,000 today, with inflation at 2.5% costs will be much higher in the future:

Today	\$20,000
20 years out	\$32,800
40 years out	\$42,000
50 years out	\$68,700

RDSP saving is an excellent way to mitigate the negative effects of inflation.

RDSP Capital

Funds accumulated in a RDSP can come from the following sources:

- ◆ Contributions to a RDSP (to a lifetime maximum of \$200,000)
- ◆ Tax free federal grants (to a maximum of \$90,000)

- ◆ Accumulated tax free growth in the RDSP (within the \$200,000 limit)

When you combine the three inputs shown above, they are a powerful wealth generator for a special needs individual. Plan holders and family who contribute only \$1,500 a year over 20 years can potentially receive \$70,000 of tax free money from the federal government as a Canada Disability Savings Grant (CDSG). Even without contributions, another \$20,000 of tax free federal payments into the RDSP is entirely possible as a Canada Disability Savings Bond (CDSB) – bringing the total federal contribution to \$90,000. That's a three for one payoff.

Plan holders and/or family members (or any one for that matter) can contribute as long as total RDSP contributions do not exceed \$200,000. While contributions in excess of annual allowable amounts may not be eligible for CDSG, they will accumulate tax free inside the RDSP.

The annual Canada Disability Savings Bond entitlement is calculated as follows:

Beneficiary or Family Income	Bond
\$21,287 or less	\$1,000
From \$21,287 to \$37,885	Reduced to zero as income increases

The annual Canada Disability Savings Grant entitlement is calculated as follows:

Beneficiary or Family Income	Grant	Yearly Maximum
Income of \$75,769 or under		
First \$500 contribution	\$3 for each \$1 contributed	\$1,500
Next \$1,000 contribution	\$2 for each \$1 contributed	<u>\$2,000</u>
		\$3,500
Income over \$75,769		
First \$1,000 contribution	\$1 for each \$1 contributed	\$1,000

The Power of Long Term Saving Inside and Outside a RDSP

If we assume that a RDSP is opened for a disabled family member at age 10, 20 years of accumulated funds at a 5% return (non taxable) would mean that when the beneficiary at age 30 there would have between \$99,200 and \$198,600 (depending on contributions) as shown in the three illustrations below. If the plan were to continue for another 20 years (until the age 50), the value of the plan would be between \$263,600 and \$526,400. That is truly amazing for contributions ranging from \$10,000 and \$30,000 in total.

The contribution assumptions for the accumulated funds mentioned above (and in the illustration below) are as follows:

- ◆ Contribution of \$500 per year for 20 years – total \$10,000
- ◆ Contribution of \$1000 per year for 20 years – total \$20,000
- ◆ Contribution of \$1,500 per year for 20 years – total \$30,000

Since RDSP beneficiaries must qualify for the disability tax credit under the Income Tax Act and since the disability tax credit refund is about \$1,500 a year, the entire RDSP contribution can be funded by the tax refund.

RDSP – Growth Example

Contributions, Grants and Bonds (Annual)			
	A	B	C
Contribution	\$500	\$1,000	\$1,500
Grant and Bond	<u>\$2,500</u>	<u>\$3,500</u>	<u>\$4,500</u>
Total	\$3,000	\$4,500	\$6,000
Accumulated Funds – RDSP			
After 20 Years			
Contribution	\$10,000	\$20,000	\$30,000
Grants and Bonds	\$50,000	\$70,000	\$90,000
Income	<u>\$49,200</u>	<u>\$59,800</u>	<u>\$78,600</u>
	\$99,200	\$149,800	\$198,600
After 40 Years			
Contribution	\$10,000	\$20,000	\$30,000
Grants and Bonds	\$50,000	\$70,000	\$90,000
Income	<u>\$203,600</u>	<u>\$304,800</u>	<u>\$406,400</u>
	\$263,600	\$394,800	\$526,400

With relatively modest contribution to a RDSP (from \$500 to \$1,500 annually over 20 years), the accumulated balance in an RDSP is huge compared with the much smaller amounts if the same funds are invested in a conventional investment portfolio.

Investment Portfolio – Growth Example

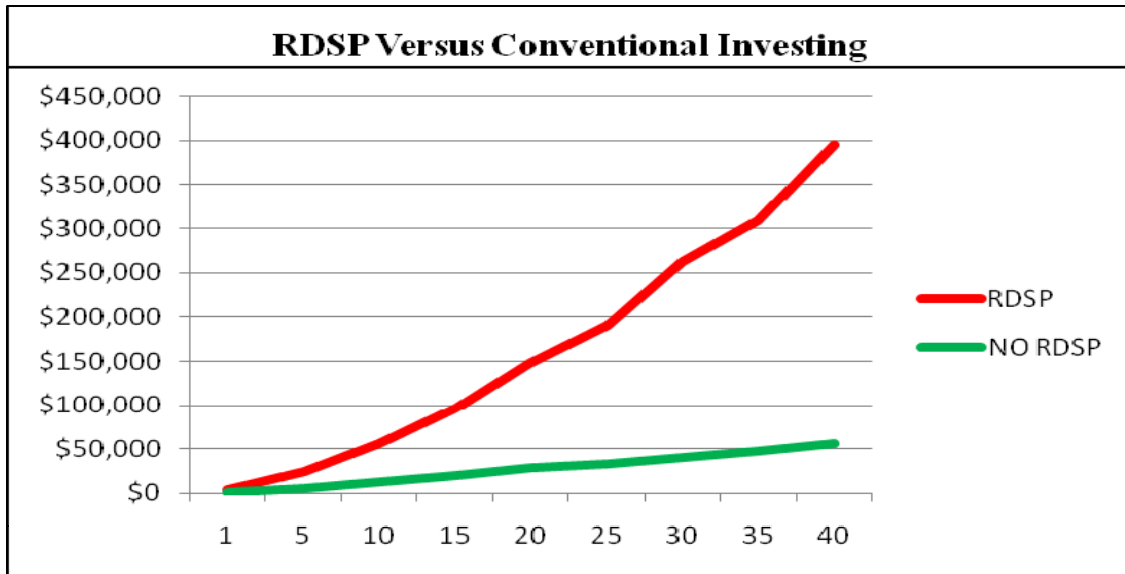
Accumulated Funds – Invested out of RDSP			
After 20 Years			
	A	B	C
Contribution	\$10,000	\$20,000	\$30,000
Income after tax	<u>\$4,100</u>	<u>\$8,300</u>	<u>\$12,400</u>
	\$14,100	\$28,300	\$42,400
After 40 Years			
Contribution	\$10,000	\$20,000	\$30,000
Income after tax	<u>\$18,100</u>	<u>\$36,300</u>	<u>\$54,400</u>
	\$28,100	\$56,300	\$84,400

Advantage RDSP

The RDSP obviously holds a huge funding advantage for a special needs individuals over simply investing in a taxable portfolio. The advantage of the RDSP after 20 and 40 years is as follows:

	A	B	C
20 years	\$85,100	\$121,500	\$156,200
40 years	\$235,500	\$338,500	\$442,000

The accumulated amounts (in illustration B) with and without using a RDSP are illustrated on the graph below.



A family with a special needs member simply cannot ignore the RDSP and how it can fit into long term financial planning. RDSPs can be used alone or in conjunction with other planning vehicles such as Henson Trusts.

RDSP Versus a Henson Trust

The following compares a Henson trust with a RDSP.

RDSP Versus Trusts	RDSP	(Henson) Trust
Assets Distributions		
Restricted to beneficiary	Yes	No
Income Distribution Flow		
Discretionary	No	Yes
Annual contribution limit	No	No
Lifetime contribution limit	Yes	No
Generally assets and income can be structured to not affect provincial entitlement for disabled	Yes	Yes
Payments to beneficiary after age 60 are restricted	Yes	No
Ability to collect federal CDSG and CDSB amounts	Yes	No
RDSP is effective way for individuals who are legally competent to fund their future finances	Yes	N/A
Assets can be sprinkled to others	No	Yes
Distributions on death subject to provincial intestacy laws if beneficiary is not legally competent	Yes	No

There are certainly differences between the two options to accumulate capital for a person with disabilities. Only by looking at the particular circumstances will one know the relative advantages and disadvantages of each but in most cases both options should likely be used for income support and capital accumulation.

RDSP Issues

RDSPs do have certain peculiarities that need to be understood up front some of them are as follows:

- ◆ RDSP can only be for the benefit of the beneficiary
- ◆ Once the beneficiary reaches the age of majority, distribution on death is subject to terms of beneficiary's will or provincial intestacy laws
- ◆ If a beneficiary is not legally competent there would be no will and estate distributions would be dictated by provincial intestacy laws
- ◆ Withdrawals will be limited if CDSG and CDSBs in the previous ten years exceed RDSP contributions
- ◆ If a RDSP beneficiary reaches age of majority but is not legally competent, parents must obtain guardianship to set up a RDSP
- ◆ Investment choices offered by financial institutions may be restricted to their funds and discretionary management may not be available

Conclusion

RDSPs should definitely be part of long term financial planning for an individual with disabilities. The technical issues are complicated but they can be overcome. RDSPs offer a huge tax free government contribution, they allow tax free compounding, they do not affect social assistance benefits and they allow income to be taxed in the hands of individuals who are usually in lower tax brackets. They beat all other tax deferred income plans hands down.

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