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commentary

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Good News for People with Disabilities in the Federal Budget

Once again, Finance Minister James Flaherty demonstrated his commitment to people with disabilities, their families and to the Registered Disability Savings Plan (RDSP) in his 2012 Budget. When the Registered Disability Savings Plan was launched in December 2008, Minister Flaherty promised to review the plan in three years to assess its effectiveness and improve elements that were identified as problematic.

Since 2008, nearly 55,000 people with disabilities have opened RDSPs and have contributed $220 million. Over the same period, the Government of Canada has contributed nearly $450 million. By the end of 2011, people with disabilities had amassed assets of well over $670 million, thanks to the Registered Disability Savings Plan.

In spite of the apparent success of the Plan, Minister Flaherty kept his word and launched the promised three-year review of the program in December 2011 and then, in his Budget speech, announced four significant measures that will make the RDSP more accessible and useful for people with disabilities and their families.

"Qualified Family Members" may now act as holders of new RDSPs

Parents, spouses and common-law partners will be able to act as holders of RDSPs opened in the next four years where the beneficiary is deemed not to have contractual capacity.

To date, adult beneficiaries without contractual capacity who live outside British Columbia have been deterred from opening RDSPs. In these situations, current legislation requires that another person be "legally authorized" to act as account holder of their RDSP. In

British Columbia, people without contractual capacity may legally authorize a Representative to assist them under the *Representation Agreement Act*. In other provinces and territories, however, delegation of legal authority to manage financial affairs of an adult requires that the beneficiary be deemed "incompetent" and another person be appointed to manage his or her affairs. This is achieved through adult guardianship legislation and usually requires a court order. The process is complicated, expensive and, most importantly, removes many rights and sometimes much of an individual's "personhood." By and large, neither people with disabilities nor families like the process.

In recognition of the problem and the work that some provinces, such as Newfoundland and Labrador, have undertaken to remedy the situation, Budget 2012 will enable spouses, common-law partners and parents of adults who are deemed not to have contractual capacity to act as holders of their RDSPs if these are opened in the next four years. This is great news for many individuals who have, to date, been deterred from opening RDSPs because they have not had a legal account holder. The announcement will enable these people to open RDSPs while, at the same time, providing provinces and territories time to amend their legislation to remedy the problem.

More specifically, if a financial institution doubts the contractual capacity of an adult who wishes to open an RDSP, the spouse, common-law partner or parent of the adult will be considered a "qualifying family member." The qualifying family member will be able to act as holder of the RDSP, which will enable him or her to open and manage the RDSP. To ensure qualifying family members do not take control of RDSPs without the assent of the beneficiary, the financial institution will be required to notify the beneficiary when a qualifying family member opens an RDSP on his or her behalf.

If a beneficiary's circumstances change, and the financial institution has reason to believe that he or she is subsequently contractually competent or if the beneficiary provides evidence that she or he is contractually competent, the beneficiary may choose to replace the qualifying family member in the role of holder.

If another person becomes a legally authorized person (e.g., a guardian, committee, tutor, trustee, curator or Representative under BC's *Representation Agreement Act*), then he or she will replace the qualifying family member as holder. In other words, a person who is legally authorized under provincial law will replace a qualifying family member under federal law.

This is a temporary option to allow provinces and territories additional time to enact legislation that will provide an option to adult guardianship. It will be available from the date that the legislation receives Royal Assent until the end of 2016, although a qualifying family member who becomes a holder under this option can continue to act as holder after 2016. The measure will not apply where an RDSP is already open or where a beneficiary already has a legal representative.

The New Proportional Repayment Rule

A new "Proportional Repayment Rule" will replace the "10-year rule" providing people with greater access to the funds in their RDSPs without facing the draconian punishment of the 10-year rule: repaying up to $45,000 in federal government contributions irrespective of the size of the withdrawal.

More than any other single characteristic of the RDSP, people have expressed concerns with the "10- year rule." This provision has deterred people from contributing to RDSPs – some as a result of not knowing whether they will need their money before they can withdraw it without penalty and others because they are not confident that they will live long enough to reap the benefits of their savings. The "10-year rule" refers to the holdback amount – i.e., any government contributions made in the 10 years immediately prior to a withdrawal and which currently must be paid back whenever a withdrawal is made.

The "10-year rule" will be replaced with the "Proportional Repayment Rule" for withdrawals starting in 2013. The current "10-year rule" will continue to apply in situations in which the beneficiary passes away or where the beneficiary loses eligibility for the Disability Tax Credit.

The "Proportional Repayment Rule" will require that, for each $1 withdrawn from an RDSP, $3 of any Canada Disability Savings Grants and Canada Disability Savings Bonds received in the previous 10 years be repaid, to a maximum of the holdback amount. These repayments will reduce the holdback amount and will be attributed to the oldest Grant and Bond amounts.

For example, suppose Barb opened an RDSP in 2008, contributed $1,500 each year and received the maximum Grant and Bond of $4,500 each year through 2017. Ignoring investment income, the RDSP would contain $15,000 in personal contributions and $45,000 in government contributions for a total of $60,000. Let's assume that Barb had a financial crisis and needs $1,000 – e.g., for home maintenance, to purchase a piece of equipment or to repay a debt.

Under current rules, withdrawing any amount would result in the repayment of the entire holdback amount. In the example above, the holdback amount (government contributions made in the previous 10 years) would equal $45,000. To access any amount of her $60,000, Barb would need to repay the entire $45,000. Under the new "Proportional Repayment Rule," Barb would need to repay $3,000, which is three times her withdrawal of $1,000.

This change will provide people with much greater access to their funds, while at the same time deterring them from withdrawing funds with the intent of re-contributing them to their RDSP to receive the matching Canada Disability Savings Grant.

Maximum and Minimum Withdrawals

Another positive measure resulting from the RDSP Review is the proposal to allow more funds to be withdrawn from RDSPs where government contributions exceed personal contributions.

Currently, when government contributions are greater than personal contributions, the total amount withdrawn in a given year cannot exceed the amount determined by the Lifetime Disability Assistance Payment formula. Because the formula is intended to stretch funds over people's lifetimes, and because 83 is the age used for life expectancy, this rule is restrictive for people who might have shorter life expectancies and for people who want to utilize their RDSP to improve their lives earlier on.

The new rule will permit individuals in these circumstances to withdraw up to 10 percent of their RDSP, as determined by the value of the Plan at the beginning of any given year. Combined with the new Proportional Repayment Rule, the change will permit much greater flexibility in the use of RDSP funds. The rule will not apply to situations where personal contributions are greater than government contributions, in which case there are no limits on the amount withdrawn in a given year. Nor will the current rules change governing specified years (where a medical doctor attests that a beneficiary has five or fewer years to live). The new rule will be effective in 2013.

For example, suppose that Catherine's family opened an RDSP for her when she was 13, government contributions will exceed personal contributions and her RDSP will be worth $320,000 when she is 43.

Under current rules, she would be limited to a withdrawal of approximately $8,000 in that year, calculated with the Lifetime Disability Assistance Payment (LDAP) formula (Fair market value/(80 + 3 – age of beneficiary) + any annuity payments). In Catherine's situation, the calculation would be: $320,000/(80 + 3 – 43) = $8,000.

Under the newly proposed rules, she will be able to withdraw the greater of the LDAP formula, in her case $8,000, and 10 percent of the market value of the RDSP, which would be $32,000(10 percent of $320,000).

In short, Catherine will have much more flexible access to money in her RDSP under the new rules.

Rollover of RESP Investment Income

Budget 2012 also proposes to permit a (tax-free) rollover of investment income in a Registered Education Savings Plan to an RDSP in certain circumstances starting in 2013.

The rollover will be possible where the RESP and RDSP share a common beneficiary and the beneficiary is eligible to make a contribution to his or her RDSP (resident of Canada and under age 60). In addition, one of the following conditions must be met:

- the beneficiary is not able to pursue post-secondary education because of a “severe and prolonged” mental impairment
- the RESP is at least 10 years old and each beneficiary is at least 21 or older and not pursuing post-secondary education
- the RESP is 35 years old.

Currently, when the latter two conditions are met, an RESP can be collapsed, returning the personal contributions to the parents (subscriber) and the government contributions (Canada Education Savings Grant and Bond) to the government. In addition, the parents can receive an “accumulated income payment” (AIP) from an RESP. An AIP is the investment income earned in an RESP. It is returned to the subscriber when the RESP beneficiary is not pursuing post-secondary education and the RESP is being terminated. Currently, the AIP is included in one of the parents’ incomes for income tax purposes and is also subject to an additional 20 percent tax. The amount of tax can be reduced by contributing part of the AIP to an RRSP.

Under the proposed rollover of a Registered Education Savings Plan to an RDSP, the following will occur:

- The RESP investment income will be rolled over to an RDSP on a tax-free basis, if the beneficiary is eligible to make contributions and has adequate contribution room. The rollover will be considered a personal contribution but will not attract matching Canada Disability Savings Grant amounts. The rollover will be taxable on withdrawal.

- The subscriber contributions to the RESP will be returned to the subscriber and can subsequently be contributed to the RDSP, attracting matching Canada Disability Savings Grant amounts.

- Any Education Savings Grant and Bond amounts must be returned to the federal government.

The value of the rollover to an individual subscriber will vary depending on the value of the RESP and other taxable income. The tax savings need to be compared to the value of the Canada Disability Savings Grant that could be levered with the RESP funds, once the tax on the AIP has been paid.

Termination of an RDSP following Cessation of Eligibility for the DTC

People with illnesses and conditions that result in temporary ineligibility for the Disability Tax Credit (DTC) will be able to keep their RDSPs open for an additional four years where it is likely they will once again become eligible for the Disability Tax Credit.

Currently, a beneficiary who is unable to re-establish eligibility for the Disability Tax Credit when his or her eligibility expires must close the RDSP by the end of the year following the first full year of ineligibility for the DTC. This rule triggers the repayment of the holdback amount and the requirement to close the RDSP. The remaining money becomes an asset of the beneficiary and may disqualify that individual from provincial disability benefits.

New rules proposed in Budget 2012 will permit beneficiaries whose DTC eligibility expires to keep their RDSPs open for an additional four years. To utilize this measure, a medical practitioner must certify that a person's condition makes it likely that he or she will re-qualify in the foreseeable future. The beneficiary will need to complete and submit an election (a federal government form), along with medical certification, to a financial institution. The beneficiary must submit the election before the end of the year following the first full calendar year of DTC-ineligibility.

When a beneficiary submits the form and an election is made, the following rules will apply, beginning in the first full calendar year for which the beneficiary is not eligible for the DTC:

- Contributions will not be permitted, including RESP rollovers. However, rollovers from the Registered Retirement Savings Plan or Registered Retirement Income Fund of a parent or grandparent will be permitted.

- The RDSP will not be eligible for new Grant or Bond contributions while the election applies.

- No new entitlements for the Grant or Bond amount will be generated while the beneficiary is not eligible for the DTC.

- Withdrawals will be permitted and the current 10-Year Repayment Rule will continue to apply.

An election will generally be valid for four years after the first full year in which a beneficiary is DTC-ineligible. The RDSP must be terminated by the end of the first year for which there is no longer a valid election.

If a beneficiary once again becomes eligible for the DTC while an election is valid, the usual RDSP rules will apply, beginning with the year for which the individual becomes eligible. If the beneficiary becomes DTC-ineligible again at a later time, a new election could be made.

This measure will apply to elections made after 2013. In the meantime, beneficiaries who have become ineligible will not have to close their RDSPs before the end of 2014 to make use of this provision.

Administrative Changes

The Registered Disability Savings Plan is a complicated product and the requirements of financial institutions that offer them have been significant. Some of these administrative requirements have been eased in Budget 2012.

First, deadlines have been relaxed. Currently, financial institutions must notify Human Resources and Skills Development Canada within 60 days of the establishment of an RDSP and transfers must be completed within 120 days of the new plan being established. Under proposed changes, these deadlines will be replaced with the requirement that an RDSP issuer act "without delay."

In addition, Human Resources and Skills Development Canada will assume the responsibility for transferring much of the historical information to the financial institution holding the new plan when an RDSP is transferred from one financial institution to another. Previously, the responsibility for transferring historical data rested with the financial institution from which the RDSP was being transferred.

Finally, Budget 2012 proposes to amend the Canada Disability Savings Regulations to eliminate the 180-day deadline within which a financial institution is currently required to submit an application for a Canada Disability Savings Grant or Bond.

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The Caledon Institute of Social Policy occasionally publishes reports and commentaries written by outside experts. The views expressed in this paper are those of the author.

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