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The RDSP Has Its Own Abilities and Disabilities

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HR Managers should do their homework on the new Registered Disability Savings Plan (RDSP) before discussing RRSPs and TFSAs with disabled employees. Otherwise they may be providing ill advice.

The RDSP is designed to help with long-term savings since a disabled person has a much lower income potential and significantly higher medical expenses than a healthy individual. This financial strain makes retirement savings difficult if not impossible, and in this context the RDSP fills a very important need.

Unveiled in the [2007 budget](#), the RDSP is currently offered by only two of the five Canadian chartered banks. It has so far flown under the radar compared to the launch of the tax-free savings account (TFSA) since less than 1% of the Canadian population is expected to qualify for it. But for someone who does qualify for the RDSP, this will be a very powerful and attractive savings plan.

Employers should be aware of this new savings vehicle in order to educate disabled employees on how to best direct their savings. This niche offering can provide those with a qualifying disability a significant sum of money as a result of generous grants and bonds from the Canadian government.

To be considered disabled for purposes of opening up an RDSP, one must qualify for the disability tax credit by having a qualified medical practitioner certify a “marked restriction” in physical or mental ability to perform normal daily activities (form T2201 – *Disability Tax Credit Certificate*).

The disability tax credit usually provides tax relief of about \$1,500 per annum (combined federal and provincial) depending on income levels, and can be transferred from a dependant or spouse if the disabled individual has insufficient income to utilize the credit themselves. The disabled person can even be a dependant family member such as a sibling, grandparent, uncle/aunt, or niece/nephew who is reliant on the person filing for the tax credit for any of the basic necessities of life.

RDSP accounts consist of contributions by the Plan holder, government grants and bonds, and investment earnings. The main financial benefits of the RDSP are as follows:

- Canada Disability Savings Grant (CDSG);
- Canada Disability Savings Bond (CDSB); and
- Tax sheltered investment earnings.

The only time taxes are ever paid on the RDSP is when money is withdrawn from the Plan. All investment earnings plus the grants and bonds become taxable income when withdrawn. The plan holder’s contributions are always considered after-tax dollars. This makes the RDSP similar to the Registered Education Savings Plan (RESP). The RDSP is also quite similar to the TFSA and RRSP with respect to the tax sheltering of investment earnings feature.

As far as what investment vehicle is most effective for a person with a qualified disability, the RDSP, with its free grant and bond money, is hands down the best vehicle, as the following examples demonstrate.

Example 1 - Family income of \$75,769 or less:

CDSG monies are remitted at \$3 for every \$1 contributed to the RDSP on the first \$500 of contributions; plus \$2 for every \$1 contributed on the next \$1,000.

Therefore, a contribution of \$1,500 would receive a matching CDSG of \$3,500.

Example 2 - Family income of more than \$75,769:

CDSG monies are remitted at \$1 for every \$1 contributed on the first \$1,000 of contributions.

Therefore, a contribution of \$1,000 would receive a matching CDSG of \$1,000.

Example 3 - Family income of less than \$21,287:

CDSG monies are remitted at \$3 for every \$1 contributed to the RDSP on the first \$500 of contributions; plus \$2 for every \$1 contributed on the next \$1,000. In addition, a \$1,000 CDSB is provided.

Therefore, a contribution of \$1,500 would receive a matching CDSG of \$3,500 plus \$1,000 CDSB or \$4,500 in total.

(Note: The CDSB does not require any contributions to the RDSP. Also, the CDSB amount decreases to \$0 as family income approaches \$37,885.)

Lifetime Maximums

The RDSP program offers a maximum amount of CDSG monies totaling \$70,000 and CDSB monies totaling \$20,000. Therefore, if maximum contributions are made annually over a 20-year period, the maximum grant and bond monies will be reached. There are no annual limits on the amount that the plan holder contributes to an RDSP, although there is a lifetime limit of \$200,000.

Projected RDSP Balances

If a person with a qualifying disability is able to maximize the government subsidies to the RDSP and do a decent job investing the assets, the power of compound interest will provide a very significant nest egg.

If \$1,500 of contributions per annum are made over a 20-year period beginning at age 30 for a disabled person, projected RDSP savings by age 60 would be \$280,000 for families with earnings less than \$21,287, or \$230,000 for families with earnings greater than \$21,287 (and less than \$75,769). This assumes a conservative 4% per annum investment return and produces substantial savings that are unmatched by any other savings vehicle available.

Withdrawals from a RDSP

Payments from the RDSP must start at age 60 and are payable for the lifetime of the Plan holder according to a prescribed formula. As mentioned earlier, the interest, grant, and bond portion of the payments that come out of the RDSP are taxable as regular income. However, payments even though taxable do not count toward income-tested benefits like welfare payments (most provinces), Old Age Security, Guaranteed Income Supplement, and GST rebates. And of course, Canada Pension Plan benefits are always unaffected by income levels.

What's the Catch?

Unfortunately, there is a catch to the RDSP: a person must continue to have a qualifying disability and be eligible for the disability tax credit throughout the lifetime of the RDSP. Therefore, any ineligibility as a result of recovery or death

would result in a forced closure of the Plan.

The financial implications of becoming ineligible before age 60 are potentially huge. The RDSP will terminate in the year that eligibility ceases and all grants and bonds that were not in the plan for 10 or more years will need to be refunded to the government.

Another mild “catch” is that the CDSG and CDSB are only available for years up to age 49. This means that in order to be eligible for the maximum government subsidies, one must first qualify by age 30.

When you exclude disabled persons who: 1) are not going to remain disabled over a prolonged period, 2) have a high incidence of mortality as a result of their disability, and 3) are age 50 or older at onset of qualifying, you are removing a large segment of the very population that the RDSP could benefit.

The RDSP therefore has a certain amount of risk, assuming that one would be better off saving in a TFSA or RRSP if it were known in advance that the grants and bonds would inevitably be refunded. However, since grants and bonds are repaid without repaying the investment earnings, the Plan may still have been well worth it. On the flip side, investment losses come off the amount of grants and bonds that need to be returned to the government.

The age restriction on grants and bonds in combination with the strict qualifying rules that would even exclude many employees on Long-Term Disability (LTD) would significantly reduce any potential demand for employer sponsored “Group RDSPs”.

Program with promise

The RDSP is a powerful way for families of disabled persons to save for the future of their disabled love one, or for a disabled person to save for themselves. Employers of disabled employees can also play a role in education of the program when dealing with employees on LTD who may qualify.

There is a further potential for companies to assist in establishing individual plans and making contributions to RDSPs on behalf of qualifying employees. By simply directing \$1,500 in LTD benefits, an employer could help their disabled employee establish significant replacement income which can begin around the time that their LTD benefits expire.

As the RDSP gains in popularity, I suspect that the Canada Revenue Agency will see more applicants for the disability tax credit now that the incentives have been significantly increased. A 30-year old disabled person could have a RDSP balance of \$280,000 at age 60 financed entirely by the annual \$1,500 disability tax credit, government grants, and investment returns of only 4% per year.

However, it appears that the savings plan is in its initial stages and has its share of glitches. The RDSP is designed to promote long-term savings. So while it is understandable to penalize someone for voluntarily accessing funds before the designed maturity date of the RDSP, it seems overly harsh to penalize someone with a disability for recovering or even worse for dying. Removing up to nine years of grants and bonds is a severe penalty for what is an involuntary event. The forfeit of these supplements would be a significant loss to one’s RDSP savings potential.

Although the 2008 budget did not make any changes to the RDSP, it did promise to review the RDSP every three years to ensure that the Plan continues to meet the needs of Canadians with disabilities. I believe that in these reviews, the government needs to come up with a more reasonable way to deal with some of the above-mentioned delicate situations. The RDSP has a lot of promise and should be a program that someone with a qualifying disability should be able to count on no matter what the future holds.

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