



Using life insurance in a Henson trust

Who can benefit from a Henson trust?

Persons with severe disabilities may rely on provincial government programs for basic income and for financial assistance in purchasing medicine and support devices. Often their parents and other close family members provide their own assistance to help enhance the disabled person's quality of life.

What happens if the parents or other family members die? How will the disabled person get that enhanced support? One solution is a Henson trust funded with life insurance.

What is a Henson trust?

A Henson trust is a form of *inter vivos* or testamentary trust for disabled beneficiaries, that also protects their entitlement to provincial disability support benefits. Many provinces' disability support programs (like the Ontario Disability Support Program, or ODSP) have strict asset and income means tests. If a relative or friend simply gives the disabled person money or assets to help them out, the province will discontinue its support until the disabled person spends down their assets and requalifies. A Henson Trust allows a disabled person's relatives and friends to contribute to the disabled person's well being without disentitling that person to provincial support. The trust beneficiary must be "named" in the trust (i.e. by proper name, not by relationship to settlor or testator).

A Henson trust is an *absolute discretion trust*; the trustee has full discretion over whether and how much income or capital they distribute to the beneficiary. The beneficiary has no legal way to force the trustee to give them any capital or income from the trust. However, as a practical matter the trustee may administer the trust in a way that enhances the beneficiary's quality of life, which is the real purpose for creating a Henson trust. A lawyer must be retained to write the trust document to ensure that the trust satisfies the purposes for which it has been created without offending the provincial means test.

The term, *inter vivos* is Latin for "during life." An *inter vivos* trust is a trust created and operated during the lifetime of the person who created it, the settlor. The term, "testamentary" refers to a trust that comes into being at the settlor's death. Many testamentary trusts are created as part of a person's will, though they are not part of that person's estate.



Legal status of Henson trusts in Canada

The legal foundation for Henson trusts was first established in Ontario in *Ontario (Director of Income Maintenance Branch of the Ministry of Community & Social Services) v. Henson (1987)*, 26 O.A.C. 332 (Div. Ct.), aff'd in (1989), 36 E.T.R. 192 (Ont. C.A.). The Court of Appeal affirmed the Divisional Court's conclusion that since the beneficiary had no enforceable right to any trust property, the Director could not treat those assets as belonging to the beneficiary for purposes of social benefits eligibility.

The Supreme Court of Canada affirmed *Henson* in *S.A. v. Metro Vancouver Housing Corp.*, [2019] 1 SCR 99, 2019 SCC 4. The Supreme Court held that because the trust beneficiary had no actual entitlement to the trust property, their interest in the trust was not an asset that could disqualify them from eligibility under provincial disability support programs.

While *S.A. v. Metro Vancouver Housing Corp.* has expanded the *Henson* rule to all Canadian provinces and territories, the settlor's lawyer must still take care to ensure that the trust they are drafting complies with their province's or territory's social benefits eligibility rules. A province or territory can still word their rules to include assets in a Henson trust in the provincial or territorial means test.

Tax treatment of a Henson trust

If established by will, a Henson trust may qualify as a Qualified Disability Trust (QDT) under subsection 122(3) of the Income Tax Act (Canada)¹. A QDT is a testamentary trust where the beneficiary qualifies for the Disability Tax Credit (DTC). If the trust elects QDT status and satisfies other criteria, it can access graduated tax rates (rather than being taxed at the top marginal rate), providing significant tax deferral and savings.

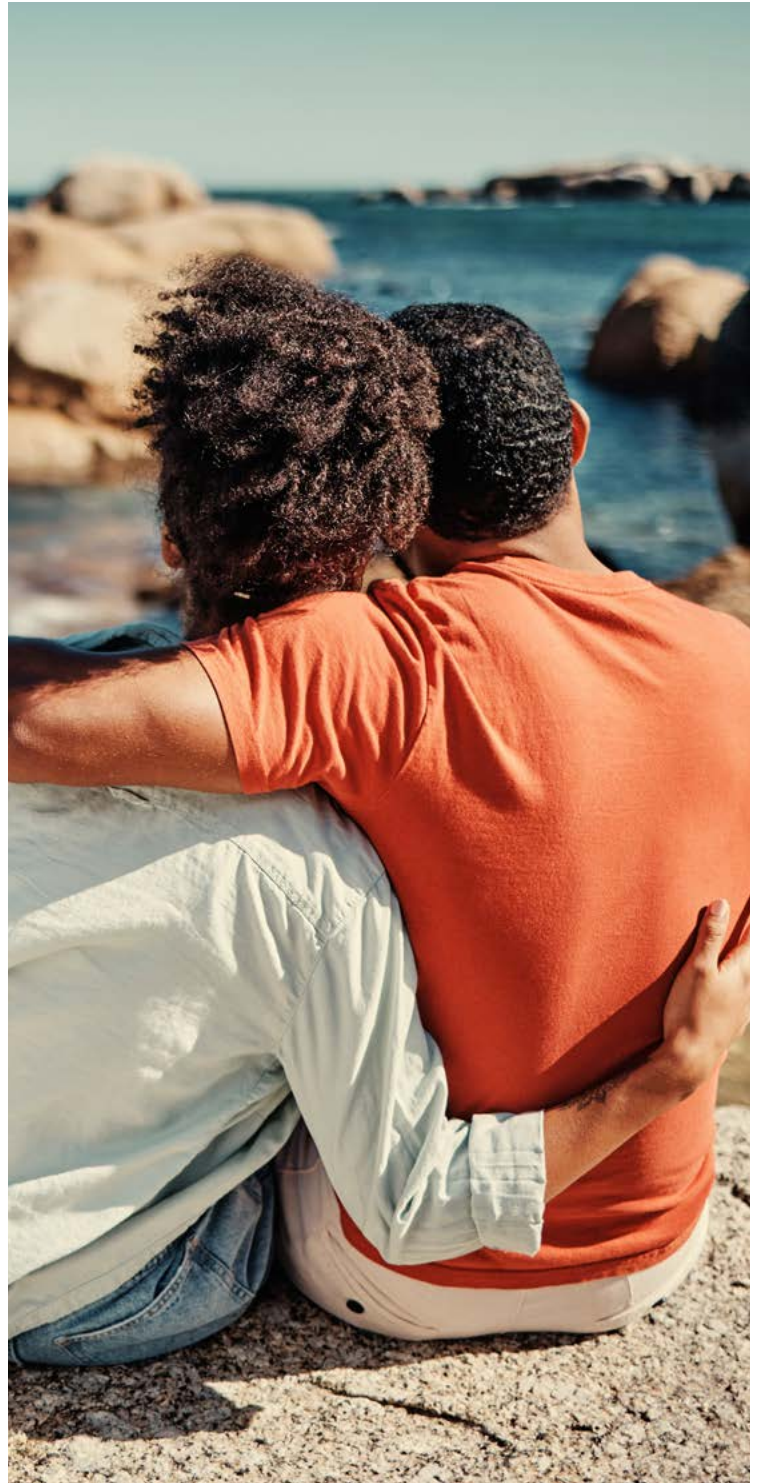
A person qualifies for the DTC when a medical practitioner has certified that they have a severe and prolonged mental or physical impairment as more particularly described under subsection 118.3(1) of the Act.

The trust can be a QDT only in years when it has only one QDT designation. Further, only one trust can designate the individual as a QDT beneficiary each year. These rules require careful planning and coordination between multiple family members.

Appointment of trustee

The trustee of a Henson Trust must be chosen with care. They must understand and adhere to the provincial disability benefits regime, such as ODSP in Ontario. Poorly structured distributions could unintentionally disqualify the beneficiary from essential supports. Trustees should be educated, ideally with legal or social work backgrounds, or be supported by professional advisors.

The trust document should also name successor trustees, or provide a mechanism for appointing a successor trustee or trustee. Also, a letter of wishes should accompany the trust to guide the trustee on the settlor's intent regarding the beneficiary's support.



¹ R.S.C. 1985, c. 1 (5th Supp.) (the "Act"). Unless otherwise noted, all statutory references herein are to the Act.



What are the advantages and disadvantages of using a Henson trust?

Advantages

- Protects the trust beneficiary's eligibility for provincial disability support.
- Helps enhance the trust beneficiary's quality of life.
- Lets family members provide for a disabled beneficiary without requiring the disabled person's impoverishment.
- Can defer or reduce taxes if established as a QDT.

Disadvantages

- The trustee must be diligent and knowledgeable in their province's disability support rules.
- The beneficiary has no legal entitlement to trust distributions.
- Trust property is deemed disposed of every 21 years for capital gains tax purposes. The usual remedy – wind up the trust after 20 years and distribute its property to the trust beneficiary – may disentitle the trust beneficiary to provincial support benefits. Further, under some provinces' laws, trust income cannot be added to trust capital after a certain number of years (21 in Ontario), but must be distributed to other trust beneficiaries.
- Legal and administrative costs can be higher than for a direct inheritance.
- Family members must coordinate their activities to avoid duplicate QDT designations.

How can life insurance serve the interests of the settlor and trust beneficiary?

A permanent life insurance policy on the life of the parent or other supporter can provide a tax-free lump-sum death benefit to the trust when that person dies. This is particularly useful if the disabled person's parents and/or caregivers are providing support from their current resources and have no reserve to provide support if they pass away.

The policy owner must name the beneficiary carefully so that the proceeds of insurance go directly to the trustee, and bypass the insured person's estate. The proceeds won't be available to the insured person's estate creditors or to the disabled person's creditors, and won't be subject to probate tax.

The trustee gains immediate access to the life insurance proceeds and can use them immediately for the benefit of the disabled person.

Life insurance provides all parties with the peace of mind that comes from knowing that the disabled person's future financial security is taken care of.

Life insurance can also provide funds for the disabled person's parents to use in equalizing an inheritance when they know that the disabled person's needs will consume a substantial part of their estate.

While we have made every effort to ensure that the information presented in this document is accurate and up-to-date, please note that the examples and information provided are for illustrative purposes only. No one should act upon the information presented here without first seeking the professional services of a personal advisor and having a thorough analysis of his/her legal or tax situation performed.

The legal rules governing trusts in this document are primarily based on common law. As a result, some of these rules may differ in the province of Quebec

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