SNTs, Qualified Disability Trusts and ABLE Accounts: Slashing Tax Liability

By Ron M. Landsman

Special needs trusts (SNTs) enable funds to be saved on behalf of an individual with disabilities without affecting their eligibility for means-tested programs such as SSI (Supplemental Security Income) and Medicaid. Since income generated within trusts is often subject to high tax rates, it s sometimes assumed that the same is true of SNTs. But for carefully constructed SNTs of modest size (less than $100,000), this is not so. In 2001, Congress passed legislation to establish qualified disability trusts (QDisTs), which qualify for much higher exemptions than regular trusts, so that in many cases, an SNT will pay no taxes at all.

What This Means

Trusts are taxed at a steep rate, reaching 35 percent when annual income hits $11,150. The standard exemption is only $100-$300. A qualified disability trust, on the other hand, is eligible for the same exemption as an individual filing a personal return $3950 in 2014. In addition, any income distributed to the beneficiary during a given tax year is deducted from trust income and enjoys a $3950 exemption on that person s individual tax filing. This means that up to $7900 of annual income can be tax-free. Additional deductions, such as trustee fees, may also apply.

ABLE Accounts

As families assess the role of SNTs and ABLE accounts in their special needs planning, they should consider the tax savings available to them through SNTs structured as qualified disability trusts. ABLE accounts, yet to be implemented by the states, will allow income to grow tax-free so long as funds are used for the listed disability-related expenses. But contributions to ABLE accounts can t exceed $14,000 annually, and they re capped at $100,000 for purposes of SSI eligibility. SNTs, on the other hand, can grow unrestricted, and funds can be spent in many more ways for a vacation, flat screen TV or art lessons.

If you assume income generation of seven percent, an SNT structured as a qualified disability trust could have assets of $113,000 before facing taxes, assuming a distribution to or for the beneficiary and no tax on him or her. If income were to grow a more typical five percent, the SNT could hold assets of $158,000 before becoming liable for taxes.

Requirements

In order to establish a qualified distribution trust, the following conditions must be met:

- The beneficiary must be receiving SSI or SSDI (Social Security Disability Income).
- The beneficiary must be under 65 when the trust is created.
- It must be a third party SNT, which is funded using assets of anyone other than the beneficiary.
- It must be irrevocable, meaning that the donor relinquishes all rights to the assets.
- The trust can have multiple beneficiaries as long as they all have disabilities.

Each Situation Is Unique

As the states roll out details concerning their varied ABLE programs, families should consult their financial advisors and special needs attorneys to determine what planning tools will best meet the needs of their loved ones with disabilities. In some cases an ABLE account will work best; in others, an SNT. Sometimes both should be used. But if the SNT can be structured as a qualified disability trust, the difference in tax savings will probably not be a major deciding factor.