Strategies for Funding a Special Needs Trust

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With all the daily responsibilities that parents juggle when one of their children has a disability (and, therefore, special needs), it s tough to find time to plan for the future. But that s what it takes when a loved one has a disability that may affect his/her ability to be self-supporting. It can be tempting to assume they ll grow out of a condition or that Medicaid treatments can fix them, so it s important to consult medical experts and care advisors early to develop realistic expectations about your child s long-term capabilities and to estimate the likely costs of being, or becoming, able to live and thrive independently. As parents, we generally recognize that we are not likely to be around to care for our child for his/her lifetime.

At 18, your child may be eligible for SSI (Supplemental Security Income), which is the entry ticket in many states to a wide range of important public benefits, including Medicaid. Since many of these are means-tested programs, having assets in the child s name usually disqualifies them from public benefit programs. On the other hand, government programs don t cover many necessary expenses, so parents should plan for how they can fill the gap.

> Special needs trusts (SNTs) have traditionally been used to accumulate resources without affecting eligibility for benefits. More recently, the federal government empowered states to establish ABLE accounts, savings tools with very different guidelines that also enable individuals and their families to set aside funds without endangering important benefits. At this writing, the Social Security Administration has recently released proposed regulations on ABLE accounts and only a few of the states expect to offer the ability to set up such accounts in 2016. This article focuses on what families should consider when funding an SNT.

What Type of SNT?

The source of funding determines the type of SNT to be established. Assets belonging to the beneficiary must be allocated to a first party SNT (perhaps later, an ABLE account), while resources from anyone else should go to a third party trust. One of the important differences is that funds left in a first party trust when the beneficiary dies are subject to Medicaid claims for program expenses paid during the individual s lifetime.

A third party trust can be established and funded during the creator s lifetime (*inter vivos*) or as a *testamentary* trust, which is set in motion through the individual s will or other estate planning documents. One advantage of an inter vivos trust is that it provides a vehicle for other family members and friends to contribute to the child s welfare at any time, including before a parent s death.

Finding the Funds

Families should always consider placing a portion of personal injury settlements into a first party SNT, since even a very large sum can quickly be dissipated by the needs of an individual with serious disabilities. For third party SNTs, family savings, inheritances and other financial gifts should be considered, each of which can then be invested in stocks and bonds for growth and protection from inflation. Ultimately, there are a number of strategies parents and families should consider:

Insurance Consider various scenarios in order to sort through the many options.

Second-to-die, or *survivorship*, life insurance policies can be a cost-effective SNT funding choice. They re often less expensive than other options since they don t pay out until the second member of a married couple passes away. But if the primary breadwinner dies first, funds may be needed immediately to cover the family s ongoing expenses. If a stay-at-home caregiver is the first parent to go, paying someone to perform those services can be costly. In such cases, individual policies might be more practical. At retirement, though, that dynamic could change, with the income producer playing a larger caregiver role. At that time, it might make sense to convert to a survivorship policy.

Term life insurance can be another relatively inexpensive path to funding the SNT. Because such policies guarantee payouts during a defined period, they typically cost less. Assuming no significant changes in one s health, they can be renewed upon expiration, although age and medical conditions often mean steeper premiums.

Whole life insurance, on the other hand, covers the entire life span and part of each premium is collected in an investment account that grows in value. Premiums are fixed.

Variable life insurance also provides lifelong coverage, but its cash value fluctuates along with financial markets.

Real Estate

The family residence may be the only home that an individual with special needs has ever known, and preserving that stability for a loved one may be an important goal. But leaving a house in the child s name can be a big mistake. In addition to affecting means-tested benefits, it may leave the individual open to exploitation.For this reason, leaving such real estate to a third party SNT is a popular funding tactic. In that fashion, it escapes the Medicaid lien to which a first party trust would expose it and can be transferred to other beneficiaries upon the child s death. If, for some reason the child needs to move and sell the property, proceeds remain in the trust.Even if the child lives elsewhere, the property can prove a savvy investment, perhaps contributing rental income to the trust. In either case, it s important to provide the trust with adequate funds to maintain the property.

Retirement Plans

Designating an SNT as the recipient of retirement plans is tricky, and unless carefully managed, good intentions can result in having all the funds distributed to the trust s beneficiary and taxed during the year of transfer. This could easily disqualify the individual for government benefits and result in unnecessarily high taxes. A notable exception is the designation of military survivor benefits to an SNT, recently facilitated through federal legislation (read about the Disabled Military Child Protection Act).When non-military retirement accounts are involved, the SNT should be structured as an accumulation trust, which can space out required minimum distributions. In addition, remainder beneficiaries, those entitled to funds remaining upon the death of the primary beneficiary, must be carefully chosen. They should ideally be younger than the beneficiary to avoid unintended distribution requirements.Because of these difficulties, families are sometimes advised to avoid designating an SNT as the beneficiary of a retirement fund. Instead, they re encouraged to draw down the retirement account in order to purchase life insurance for the SNT or to leave retirement funds to other heirs.

Getting Help

These are complicated decisions, and families should consult professionals steeped in special needs law and financial planning, since they involve considerations outside the experience of many professionals. Advisors should understand benefits law, tax regulations and insurance options. At least one advisor should have a big picture understanding of the family s goals in order to coordinate the efforts of other team members.

For most families, protecting a loved one s eligibility for government benefits, while setting aside assets to supplement them, can make all the difference for future security. Remaining eligible for government programs can be important even for a child from a financially comfortable background. The prospect of funding an SNT can seem daunting, but if families begin early enough, there are helpful strategies to consider.