



Estate Planning for Parents of Children with Special Needs: Special Needs Trust

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Situation: Couples with young children often have a variety of insurance needs. The Foremost reason young couples should purchase insurance is to make sure to replace lost income, both in the event of a premature death or disability, and payoff mortgage and debts. Within this segment you may find some raising a child with special needs since the US Census Bureau Report “Disabilities and American Families” indicates that one in every 26 American families reported raising a child with a disability. Couples raising a child with a disability have unique planning considerations.

The greatest concern for parents of a child with special needs is not knowing what will happen when they are no longer able to care for the child because of their own health issues or, more critically, after their deaths. While there may be an abundance of love in the family, there may not be adequate financial assets to maintain the lifestyle that the parents desire for their child. However, even for families with significant assets now, the future is unknown and special needs may last the child’s lifetime. As parents grow older, their own aging and health care issues may consume a greater portion of their assets than anticipated, thus impacting the care that can be provided to the child.

Planning is not optional for such parents. It is crucial and can be complex to preserve needs-based assistance while assuring that the child will have the ordinary comforts of life that are not provided by governmental agencies. Public assistance programs such as Social Security and Medicaid are designed to provide only some very basic medical care and possibly shelter for disabled persons, they are an important aspect of the financial care of the child with special needs. These programs are often needs-based and never provide more than the basics. They do not provide the child the “pleasures of life,” such as vacations, recreation, education, job training, rehabilitation, computer equipment, transportation, and so forth. Those items and others must all be funded from other sources, and those funds may be more difficult to obtain as parents grow older.

Because public programs are needs based, it is important that these additional expenses be provided in a manner that does not impute income or assets to the child in any way that would jeopardize those benefits. One of the most used techniques to help accomplish this financial goal is the special needs trust. This *Counselor’s Corner* provides a general overview of special needs trusts.

Solution: The objective of special needs trust planning is to provide for a standard of living that is higher than basic subsistence while preventing a loss of government benefits. The use of the term special needs trust can create confusion because there are three distinct groups of special needs trusts.

The first group consists of those trusts that are funded with assets already legally owned by the child with special needs. These trusts are referred to as self-settled or first-party trusts. The second group of special needs trusts encompasses those funded with the child’s money but created before 1993. They are sometimes referred to as pre-OBRA trusts and can no longer be created. Finally, there are special needs trusts that are funded by the family or anyone other than the child receiving the public assistance. These are often referred to as third-party trust.

Since the focus here is on planning by a parent or other family member, the type of trust that should be established is the third-party special needs trust. The next question is how to structure and fund the trust.

How to Structure and Fund a Third-Party Special Needs Trust?

For the trust to accomplish its purpose of providing for a child with special needs, it must be funded. How the trust is funded often depends upon whether the trust is a revocable trust, an irrevocable trust, or a testamentary trust.

Living Revocable Trust. A revocable trust can be funded as soon as it is created, and additional money or assets can be placed in it at

any time by anyone. This type of trust is typically funded with assets such as investments, real estate, and bank accounts. If the parents choose to establish a revocable trust as the special needs trust and serve as the trustees, they maintain control of it in all respects. That control, however, comes at a price. During the life of the grantor, the trust is not a separate taxpayer. All of the income, dividends, and capital gains generated by the trust assets are taxed to the grantor, not the trust. If the grantor's estate is large enough to be subject to estate taxation, the trust assets are also subject to that tax. The assets in a revocable trust are also subject to the grantor's creditors.

The good news is that the parents may place assets into the trust without limitation as to amount or type. Others may also make gifts to the trust. Those gifts may or may not be subject to gift tax, depending on the size of the gift. Often, it is a grandparent who desires to put assets into the revocable trust established by the parents. This causes at least two problems. The gift from the grandparents is now in the parents' revocable trust, and any assets placed in that trust are included in the parents' estates for estate tax purposes, as well as being subject to the claims that any creditors might have against the parents. Secondly, a distribution from the trust will be considered a gift to the child, thus potentially doubling the gift transaction.

Testamentary Trust. Because the terms of a testamentary trust are contained in a will, this type of trust cannot come into existence until the death of the maker of the will (testator). The disadvantage of using a testamentary trust is that it cannot be funded as long as the testator is alive. It can be funded only after death. Consequently, the assets during the lifetime of the parents are subject to their creditors and included in their estate for estate tax purposes.

Irrevocable Trust. An irrevocable trust, while solving the concerns of both the living revocable trust and the testamentary trust, preents it's own problems. Because the trust is irrevocable, some control is lost by the parents. Because the beneficiary of the trust is not able to access the assets of the trust on his or her own, it is difficult to avoid the gift tax rules that would impose that tax on additions to the trust. For that reason, it is difficult to place large enough sums of money or assets into the trust that would be necessary to achieve the life-long purposes for which the trust was established in the first place. For all these reasons life insurance is likely to be the most cost effective and efficient method for providing the funding to help achieve long-term special needs goals.

Life insurance provides immediate funding of the trust, regardless of the timing of the deaths of the parents or other insureds. The receipt of the insurance proceeds by the trust at the death of the insured generally is subject to neither gift nor estate taxation, and life insurance death benefits are generally received income tax-free under IRC § 101(a). Thus, an irrevocable trust coupled with life insurance is one of the best ways to help provide significant funding for the future of the child. The type of life insurance policy that may be the best fit will depend upon a number of factors including premium structure and the tolerance for risk. Often a second-to-die policy is used; however, where the death of the first parent would put a strain on the surviving parent, the financial representative might consider an individual life policy.

What are the requirements that must be met by a third-party special needs trust to make sure that the trust does not result in a loss of needs-based benefits?

There are a number of requirements that have to be carefully met in the trust agreement. The trust must:

- **Be established by a person (usually parents or another family member) other than the child with special needs.**
- **Be managed by a trustee other than the child with special needs.**
- **Give the trustee full and absolute discretion to either provide assistance or not.**
- **Not give the child with special needs funds in excess of those allowed by the needs-based programs.**
- **Provide for successor trustees.**
- **Protect the trust assets against attempts by creditors and service providers to reach the assets.**

While not required, it is quite helpful to the administration of the trust and for the benefit of the child to:

- **Define the special needs and, specifically, the unique needs of the beneficiary.**
- **Provide instructions for the beneficiary's funeral in case there are no surviving family members who can do so.**



It is important to remember that many of the needs-based programs are state administered, and some of the requirements may vary from state to state.

What expenses can be paid with funds from a special needs trust?

Expenses that can be paid by a special needs trust include those that involved both the needs and the desires of a child with special needs. They are those things that can help maintain a measure of comfort and pleasure for a child but are not provided by any public or private agency. Virtually any expenses not met by public or private agencies can be paid with special needs trust funds. Expenses such as:

- **Medical and dental expenses not otherwise provided for**
- **Education**
- **Training**
- **Rehabilitation**
- **Transportation (including the purchase of a vehicle)**
- **Life insurance premiums**
- **Computer equipment**
- **Recreation**
- **Vacations**
- **Legal expenses**

What other documents should a parent consider creating to help others care for the child?

No one can provide the standard of care and love that parents can. However, parents can do much to help those assisting the child. The choice of advisors, especially trustees and caregivers, is vital, but there is much that you can do to help them to discern your wishes in caring for your child if you are not there to do so yourself. Consider developing a letter of intent.

A letter of intent is a document that is written to serve as an instruction manual for all of the persons who are either financial or personal caregivers of the child. Its purpose is to provide instructions to better enable them to manage the day-to-day care of your child, as you would do if you were there. The document should list things that the child likes and dislikes, such as hobbies, and recreational and social activities, as well as allergies and medical history. More importantly, you should include, in detail, your thoughts for his future.

In Summary: For families of children with special needs, planning is absolutely critical. Unfortunately, it is also more difficult to do for these families. The activities of daily life dedicated to the care of the whole family often crowd out the time that might otherwise be available to think about financial matters. That simple fact makes it all the more important for families with children with special needs to be surrounded by the best of advisors to ensure that the child receives financial assistance in the same quantities that he receives the love of his family.

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