

Navigating Special Needs Trusts for Children with Disabilities

SmithAmundsen Estate Planning Alert
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Estate planning for parents of children with special needs can be overwhelming. Not only do parents need to consider how to provide for their child after they are gone, but they must also consider issues relating to how an inheritance will impact federal and state aid eligibility. There are three different types of special needs trusts that allow funds to be held for a disabled individual, while allowing them to qualify for state and federal aid.

1. **Self-Settled Special Needs Trust:** These trusts are established using the assets of an individual receiving social security and/or Medicaid. The assets in the trust are used for the individual's extra and supplemental needs over and above what the individual receives from federal or state aid. Upon the individual's death, the money in the trust is paid back to the state as reimbursement for aid received by the individual during their lifetime. These trusts are sometimes referred to as "(d)(4)(A) Trusts" and are often used as part of a court settlement. For example, if there is an accident or medical malpractice claim that is paid to a disabled individual, you can petition the court to have the proceeds paid into a self-settled trust. If the individual received the asset outright, they could lose their federal and state benefits, but if the funds are contributed to the self-settled trust, then the benefits are preserved.
2. **Third Party Supplemental Needs Trust (a/k/a Third Party Special Needs Trust or Stand-Alone Third Party Supplemental Needs Trust):** A third-party supplemental needs trust is a trust created by someone other than the special needs person (the Medicaid/Social Security applicant) and funded using the third person's own assets. The terms "supplemental needs" or "special needs" refer to a provision within the trust document which directs or guides the trustee on how the trust is to be used for the beneficiary. It directs that the trustee use the trust property to meet the beneficiary's supplemental needs consistent with the beneficiary's continued receipt of Medicaid benefits. This type of trust is generally irrevocable upon formation, and the third person creating the trust would not be able to change or alter its terms. Parents sometimes create a revocable third party special needs trust for a special needs child, and preserve their power to amend or revoke it. In doing so, the parent subjects all of the assets in the trust to the claims of their creditors, so the tradeoff is flexibility for exposure. The only person who

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cannot contribute assets to this trust is the special needs person. The assets in the trust must be completely separate from the special needs person's individual assets.

- 3. Testamentary Third Party Supplemental Needs Trust** (a/k/a Testamentary Third Party Special Needs Trust): This is a special needs trust created under the terms of an individual's revocable living trust or last will and testament for the benefit of a special needs or disabled individual. This trust directs or guides the trustee on how the trust assets are to be used for the beneficiary. Since the special needs trust does not come into existence until after the death of the parent/grantor, the trust is not funded until the death of the parent/grantor. While the parent/grantor is alive, they will be able to amend or revoke the terms of the trust. Upon their death, the trust will become irrevocable, so when the special needs trust is created for the disabled person's benefit, it will be an irrevocable trust.

With all three types of trusts, the grantor decides the trustee of the trust. With both types of third party special needs trusts, the grantor of the trust gets to decide where the assets remaining in the trust will be distributed upon the death of the disabled beneficiary (money that will not be used to pay back the state). Self-settled special needs trust must include a provision that the state be repaid for benefits paid for the grantor.

Some people worry about the cost of administering a special needs trust after they are gone. They worry about burdening someone with the responsibility of managing the trust, paying and filing tax returns. Instead, they want to give the funds to a non-disabled sibling who will take care of their special needs sibling. This is just not a good idea. First, that puts a burden on the non-disabled child to keep funds separate; the non-disabled sibling also has to update their own estate plan to provide for the disabled child. Worst case scenario, the non-disabled child goes through a divorce or is sued, and the money set aside for the disabled special needs child is reached by the ex-spouse or a creditor. Worse still, the non-disabled child could die without an estate plan, and funds may not end up going to the special needs child. Special Needs Trusts provide clear instructions on how funds are to be managed for the special needs child, a structure for the management of funds, and the knowledge that the funds will be used for the benefit of the special needs individual. If there is a concern about managing funds, a corporate trustee may be used. Similarly, if parents fail to plan, and assets go to a special needs child, benefits may be temporarily lost and non-disabled family members will be left scrambling to try and establish a self-settled special needs trust.

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