Planning for beneficiaries with special needs

In brief

Protecting eligibility for government benefits

Estate planning includes deciding to whom, and how, your assets will transfer upon your death. This planning takes on additional importance when one of your beneficiaries is an individual with special needs, as the receipt of assets might affect that person's eligibility for government benefits.

Medicaid and SSI

- The two major government programs for people with special needs are Supplemental Security Income (SSI) and Medicaid (also called Title XIX).
- SSI is the basic federal safety net program for the elderly, blind, and disabled who have little or no income, providing cash to meet the basic needs of food, clothing, and shelter. While the SSI program is administered by the Social Security Administration, eligibility for SSI benefits is based on a qualified disability and financial need, not work history.
- Medicaid is also a poverty program, paying for health services and long-term care for qualifying adults and children with disabilities.

Means tested programs

- Medicaid and SSI are "means-tested," meaning the poorer the person is, the more likely he is to be eligible.
  - The asset and income eligibility limits for both programs are strict. An individual applying for SSI generally cannot have more than $2,000 in countable assets. See 20 Code of Federal Regulations § 416.1205(c). The asset limit for Medicaid is similarly restrictive, but can vary slightly from state to state. In most states, SSI recipients are automatically eligible to receive Medicaid, and it is often access to Medicaid that motivates an individual to apply for SSI.
  - Providing for a person with special needs often involves structuring ownership of assets and other resources in such a way that they are considered unavailable to that individual and not counted toward the eligibility limit.
- Specially drafted trusts, known as Special Needs Trusts or Supplemental Needs Trusts (SNTs), are often used to enable a beneficiary with special needs to enjoy the use of trust property, while still allowing the person to qualify for means-tested public benefits.
  - SNTs are divided in two broad categories based on the source of the funds that go into the trust. If the funds come from the person with special needs, it is called a Self-Settled Trust (or "first party" or "payback" trust). If someone else funds the trust, it is called a Third-Party Trust.
  - The provisions creating a SNT can be put into many types of trusts, including an irrevocable life insurance trust (ILIT) or a testamentary trust.

Assets provided by individual with special needs

A person with special needs can acquire assets in many unexpected ways, including through an inheritance or personal injury legal settlement. Structuring these funds so that the recipient can use the money without risking disqualification for public benefits programs requires careful planning.

Spend down the assets

- If the amount of money is small, it might be possible to spend the assets quickly.
- After a person applies for benefits, he has a certain limited time period to spend excess resources. He can prepay for certain services or use money to buy assets that are not counted ("exempt assets"), such as personal and household goods, tuition, home improvements, an automobile, prepaid funeral expenses, and burial plots.
- Making gifts or transferring assets for less than fair market value is considered a "divestment" and could result in disqualification for benefits.

Self-settled Special Needs Trust ("Payback Trust")

- Assets that are owned by the person with special needs can be transferred to a "first party" or "self settled trust" that will benefit him during his life. Assets in the trust are considered unavailable and are not counted for purposes of eligibility for public benefit programs.
- The self-settled trust must be established by the special needs individual, a parent, grandparent, guardian, or court. 42 United States Code (U.S.C.) § 1396p(d)(4)(A). It used to be the case that the individual could not set up the trust themselves, but this changed after the 21st Century Cures Act of 2016. The special needs individual must be under age 65 and have a disability as defined under the Social Security Act.
- Disbursements from the trust are generally used to supplement government benefits by paying for items not otherwise being paid for or provided.
- A self-settled trust must benefit that individual only.
- Any funds remaining in the self-settled trust at the beneficiary's death must first be tendered to the state to pay back the amount of government assistance (the "payback" provision).
- A "Pooled Trust" is a special kind of self-settled trust arrangement established by a non-profit association. 42 U.S.C. § 1396p(d)(4)(C). The pooled trust operates as a master trust, with separate sub-trusts maintained for separate trust beneficiaries. Each sub-trust qualifies as a self-settled trust.
  - A sub-trust can be established by a parent, grandparent, guardian, court, beneficiary, or beneficiary's agent under a financial power of attorney.
  - The assets remaining in a sub-trust of a pooled trust at the beneficiary's death must be tendered to the state to pay back the assistance provided, or in some states, the funds can stay in the master trust for the benefit of other pooled trust beneficiaries.

Assets provided by third party

The transfer of assets by parents, grandparents, or others directly to a person with special needs may hurt eligibility. To preserve eligibility, it is generally wiser to create a Third-Party Trust to receive gifts or bequests.

Third-party Special Needs Trust

- The third-party SNT must be created by someone other than the beneficiary with special needs, and all contributions must come from someone other than that beneficiary.
- The trust can be established during the third party's lifetime or it can be created at death under a will. If an irrevocable SNT is created during lifetime, it can receive gifts or bequests from others (but not from the special needs beneficiary).
- The age of the beneficiary is not a factor in the creation of these trusts.
- The trust is established so that the trustee does not have a mandatory requirement to make distributions to the special needs beneficiary – doing so could reduce eligibility for government benefits – but instead the trustee has discretion over the amount and frequency of trust distributions (and these can be made to pay for goods and services only; distributions of cash to the beneficiary are not allowed).
- Upon the death of the trust beneficiary, any remaining assets are distributed to the remainder beneficiaries, as set out in the trust document.
- There is no "payback" requirement.

Comparison of Special Needs Trusts

	SELF-SETTLED TRUST	THIRD-PARTY TRUST
Assets funding the trust	Beneficiary's own assets	Assets from anyone other than the beneficiary
Established by	Special needs individual, parent, grandparent, guardian or court	Anyone other than the beneficiary
Age of beneficiary	Under 65	Any age
Can it be revocable?	No	Yes
Can it be testamentary?	No	Yes
Payback requirement?	Yes	No

Choosing a trustee of a Special Needs Trust

- SNTs have peculiar and strict rules that the trustee must understand to avoid disqualifying the beneficiary for government benefits. For example, even if a trust is properly drafted and funded, a distribution of cash to the beneficiary is counted as income even if the money is to reimburse for an authorized expense.
- If the trustee is an individual (e.g., a parent), the trust document should anticipate the possibility that the trustee might predecease the beneficiary or simply become unable to continue as trustee (i.e., it should contain procedures that address trustee resignation and selection of a successor trustee).
- Given an SNT's increased complexity and likelihood that the trust will endure for the beneficiary's entire life, selecting a corporate trustee (or co-trustee) might be warranted.

Life insurance in special needs planning

- Individuals with special needs are often taken care of by their parents. This might work while the parents are alive, but raises the question of what to do after the parents pass away.
- Without parents around as caregivers or as a source of funds, it is often uncertain how the individual with special needs will be able to carry out activities of daily living or pay for professional care. Siblings are often unable fill the gap.
- Life insurance can be provide funds at a parent's death to help pay for caregivers or other resources that can maintain the quality of life for the person with special needs.

Who should own the policy?

- The policyowner should not be the person with special needs (or his revocable trust).
- The policyowner could be nearly anyone else, including a parent or a trust. If the owner is an irrevocable trust, the special needs beneficiary should not have a right to withdraw gifts made to the trust (this "Crummey power" is a countable asset and letting it lapse is a divestment).

Who should be the beneficiary of the policy?

- It is safest to name a properly drafted Third-Party SNT as the policy's beneficiary. This assures that the death proceeds will be available to enhance the quality of life of the individual with special needs, while preserving eligibility for public benefits.
- The person with special needs should not be the direct beneficiary of the life insurance, as the death proceeds would be a countable asset. If the beneficiary does receive the death benefit, legal assistance should be obtained to consider putting the funds in a Self-Settled SNT.
- A sibling generally also should not be named beneficiary. The sibling might not use the money for its intended purpose or might have creditors that could attach the funds. Even if the sibling gives the money to the person with special needs, this could render him too wealthy to obtain government benefits.

Another option: 529A ABLE accounts

In general

ABLE accounts (taking their name from the Achieving a Better Life Experience Act of 2014) work very similarly to 529 education accounts. Cash contributions can be made, the investments grow tax deferred, and distributions for qualified disability expenses will be tax free. These accounts are best for high-functioning special needs beneficiaries who want their own financial independence. ABLE accounts allow them to earn, save, and spend their own money without disqualifying themselves for disability benefits. These accounts are not for parents or family members of special needs individuals who want to set aside large sums for the beneficiary. There are limits on how much can be contributed each year, so those family members would be better served by a third party special needs trust.

In depth

- **Eligibility.** ABLE accounts can be established for beneficiaries who became blind or disabled before age 26. Beneficiaries can be over age 26, but the onset of their disability or blindness must have occurred before age 26. The beneficiary must be entitled to benefits under the Supplemental Security Income (SSI) or Social Security Disability Insurance (SSDI) programs. They do not actually need to be receiving these benefits, but if they are then that can be used to prove the disability. Otherwise, they must certify under penalty of perjury that they have obtained medical documentation of their disability from a physician.

- **Choosing a program.** 529A account programs are established by the states. People looking to establish an account can shop around state programs to choose what is best for them.

- **Contributions.** Contributions must be made in cash. Anybody can contribute, including the beneficiary.

  The total amount of contributions from all contributors each year cannot exceed the annual gift exclusion ($15,000 in 2020). This limitation is why ABLE accounts do not make effective estate planning vehicles. Some states may allow for state income tax deduction for contributions.

- **Investments.** Account owners are typically given a menu of investment options by the state program. If somebody is looking to establish an ABLE account and they do not like the state's investment options, they can look to establish an account in another state. The beneficiary cannot direct the investment of any contributions more than 2 times in any calendar year. The growth within the account is tax deferred.

- **Distributions.** Distributions that are used for qualified disability expenses are tax free. "Qualified disability expenses" include expenses for the beneficiary related to their blindness or disability, including expenses for education, housing, transportation, employment training, personal support services, prevention and wellness, financial management services, legal fees, and funeral expenses. The IRS and Treasury have commented in the preamble to proposed regulations that these accounts are meant to be used for expenses that help improve health, independence, and/or quality of life. If a distribution is not used for a qualified disability expense then earnings will be taxed with a 10% penalty.

- **Medicaid repayment.** After the beneficiary passes away, any remaining amounts in the account are subject to Medicaid estate recovery rules. After that, any remaining funds can be left to a designated beneficiary.

- **Rollover from 529 education account.** Funds in a 529 education account can be rolled into a 529A ABLE account for the same beneficiary tax free. These rollovers count towards and are subject to the annual exclusion limitation for all contributions for the year.

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