



Supplemental Needs Trust Distribution and Special Needs Housing Subsidies

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Administering a supplemental need trust (SNT) for a beneficiary receiving federally subsidized housing can be extremely challenging. The first challenge is the highly technical vocabulary used by these programs. Federally subsidized housing includes traditional multifamily public housing (sometimes referred to as “housing projects”), the Housing Choice Voucher Program (formerly and sometimes still referred to as “Section 8” housing), and multi-family housing, which is sometimes alternately known as “Project-Based Section 8.” Other, more specialized voucher programs, provide housing benefits for veterans and individuals with particular disabilities.

These programs are frequently lumped together as “HUD” benefits because they are partly funded and administered by the U.S. Department of Housing and Urban Development. To add to the complexity, local authorities known as Public Housing Authorities (PHAs) are responsible for the day-to-day operation of federally subsidized housing in each of their respective geographical locations, and each such PHA has its own guidelines and rules. The trustee’s next challenge is determining the type of housing support the trust beneficiary is receiving to assure compliance with relevant rules. This can be difficult because the SNT beneficiary may not know which particular program is providing housing support, and PHAs sometimes provide inconsistent and conflicting information.

Income limits apply to all HUD programs. The income limits are not universal but are based on the geographical area where the beneficiary lives. The best resource for calculating the income limit for a particular region is on the HUD website at www.huduser.gov/portal/datasets/il.html. The amount of rent a resident pays to live in subsidized housing varies based on the type of program involved but is generally based on an individual’s monthly household income from all sources. To protect the SNT beneficiary, the trustee must determine which SNT distributions are treated as household income to the HUD recipient for purposes of this rent calculation.

Changes to HOTMA Regulations

The federal Housing Opportunity Through Modernization Act (HOTMA) was passed by Congress in July 2016. However, final regulations were not published until February 14, 2023, and HUD issued supplemental guidance in September 2023. The HOTMA regulations became effective January 1, 2024. A September 24, 2024 Housing Notice (Housing Notice H-2024-9) extended the date for full compliance from the original date of January 1, 2025, to an extended date of July 1, 2025. The HOTMA regulations significantly change the treatment of SNT distributions. Before the HOTMA regulations, distributions from an SNT were not counted as household income for HUD purposes as long as the distributions were “temporary, nonrecurring, or sporadic.” In other words, as long as the trustee did not follow routine and predictable distribution patterns, SNT distributions were not counted as income to the resident.

HOTMA regulations have made substantial changes to this distribution paradigm. The new regulations focus on the *trust’s* income, treating distributions of trust income to the beneficiary as household income to determine the appropriate rent subsidy. In contrast, distributions of trust principal are excluded from the calculation.

The HOTMA regulations provide only one clearly established exception to this rule, excluding trust income used to pay health or medical expenses for a minor. Some commentators on the new HOTMA regulations believe that distributions of trust income for any beneficiary’s health or medical expenses, regardless of age, are not counted as income. Still following this more expansive interpretation is risky until further guidance is published.

Defining Trust Income

Following the HOTMA regulations, the fundamental question for SNT distributions becomes: *how do you define trust income?* Answering this question is crucial in determining whether an SNT distribution to a subsidized housing resident is treated as income that will affect the resident’s benefits or principal that will not. But while the question seems quite simple on its surface, it is anything but.

Defining a trust’s “income” is a complex legal and accounting concept governed by various state laws, and by the terms of each specific trust. Federal tax law generally treats distributions of the trust’s net income (after allocation of trust expenses) as taxable income to the beneficiary. However, only the trust’s income from interest, dividends, and rent is generally treated as income distributable to the beneficiary. Recognized capital gain is generally not considered income distributable to the beneficiary. In addition, the vast majority of states in the US have adopted some version of the Uniform Principal and Income Act (UPIA). These laws provide default rules as to which trust receipts are treated

as income and which are treated as principal, as well as the allocation of expenses between income and principal. Trust documents may overrule these default rules and grant the trustee discretion to allocate trust receipts differently than the default rules, subject to certain limits. To further muddy the waters, UPIA rules and trustee discretion are not always the same as the IRS rules determining how trust income is taxed.

The regulations seem consistent with traditional trust tax accounting rules such that the trust income allocated to the trust beneficiary is capped at the lesser of the beneficiary's distribution or the trust's net income. For example, if the trust has \$2,000 of income, but the beneficiary only receives a \$1,000 distribution, the deemed income is only the \$1,000 distributed. Conversely, if the trust only has \$1,000 of income and beneficiary receives a distribution of \$2,000, only the \$1,000 of trust income is deemed to the beneficiary. However, be forewarned that the HOTMA regulations do not provide any guidance regarding the definition of trust income or the interaction of state UPIA laws and the federal HOTMA regulations.

Pursuant to a 2019 HUD notice, distributions to or from an ABLE account are expressly excluded from a subsidized housing resident's income. This might provide a workaround. For example, if an SNT had \$500 in dividend or interest income in a given year, the trustee could first distribute \$500 to the HUD participant's ABLE account. Any other distributions would be deemed to be made entirely from principal. Alternatively, the trust could be written or amended to provide that all distributions, other than those to an ABLE account, were to be treated as principal distributions. This notice predates the HOTMA regulations, so it is unclear how it applies under the new regulations.

Relief may also come in the form of "safe harbors." Notice PIH 2023-27 allows PHAs to use income determinations from other means-tested federal public assistance programs to verify annual income. However, the decision whether or not to use the safe harbor principal will be made on a case-by-case basis by individual PHAs, which could present a challenge to trustees administering multiple SNTs in varying locations.

In short, for SNT trustees whose beneficiaries receive federal housing subsidies, there are more questions than answers at the current time. It becomes more important than ever that an SNT trustee has detailed information about the beneficiary's housing benefits, and a line of communication with the relevant PHA to determine how and when that PHA will implement the HOTMA regulations.

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