SPECIAL NEEDS ALLIANCE

When And How Do I Fund My Special Needs Trust for My Child with Disabilities?

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Several factors should be considered when establishing a third-party special needs trust (TPSNT) for a child with disabilities.

- When should the TPSNT be funded?
- How should the TPSNT be funded?

Immediate Funding

Concerning the question of when the TPSNT should be funded, for most people, the answer is that it makes little sense to fund the trust before the death of the surviving parent. Once the trust is funded, it must be administered. Administration involves filing income tax returns and frequently paying trust administration fees. In some instances, annual accountings may be required. It is usually simpler to have the parents pay for the expenses the trust would otherwise pay during the parents' lifetime. If the child with disabilities qualifies as a medical dependent, the parents may be able to claim some expenses as a medical deduction on their income tax. The exception would be in situations in which the parents are in a very high estate and gift tax situation. In those cases, it may make sense to fund the trust immediately to take advantage of current estate and gift tax laws. In those situations, the trust obviously cannot be a trust under a will but must be a standalone TPSNT.

Funding On Death

As a general rule, for most people, it makes more sense to fund the TPSNT on the death of the surviving parent.

How Much Is Necessary to Fund The TPSNT?

The next issue that frequently arises is what percentage of the parents' estate should be used to fund the TPSNT. If the parents have three children, they frequently want to divide their estates into three equal shares—one share for each child, with the TPSNT receiving the share for the child with disabilities. Careful analysis should be made as to whether this makes sense. The analysis should begin with a budget for the parents' desired standard of living for the child with disabilities. How long do the parents want the trust to last? Generally, this would be the lifetime of the child with disabilities. Is there a medical prognosis as to how long that may be?

Once the budget is developed, parents almost always realize that two of the children will likely be able to support themselves, and the child with disabilities may not, so they choose to fund the trust for the child with disabilities with a larger share. In cases where the parents do not have sufficient funds to fund the trust adequately, whole life insurance should be considered, and the TPSNT can be designated as the beneficiary. Term insurance is not appropriate because, statistically, the parents outlive the policy term. Whole life insurance premiums are more expensive, so the parents may only be able to afford less insurance. Still, they will know that the money will be available when needed. A "second-to-die" policy is usually the best option where the parents are married.

Most experts believe that for the trust to last 30 or 35 years, distributions should not exceed three or four percent of trust assets. Assuming that is true, the trust should be funded with 25 or 30 times the annual budget expenditure.

What Are Appropriate Trust Assets to Fund A TPSNT?

- Retirement Accounts. Retirement accounts are an excellent asset to use for funding a TPSNT. Under The Secure Act, adopted December 20, 2019, and The Secure Act 2.0, adopted December 29, 2022, most non-spouse beneficiaries must withdraw funds from an inherited retirement account over a ten-year period. There is an exception for "eligible designated beneficiaries" (EDBs). An individual with a disability and a chronically ill individual are both considered EDBs. These beneficiaries may withdraw the funds from the retirement account over their life expectancy, which is often more than the ten years required by non-EDBs. Individuals are considered "disabled" if they have a Social Security Determination of Disability. This means that a child with disabilities who is receiving Supplemental Security Income (SSI), Social Security Disability Insurance (SSDI), or Childhood Disability Benefits (CDB) would automatically meet this definition. By stretching out distributions from the retirement account over the longer life expectancy of the child with disabilities, that child may receive considerably more money. For example, it is anticipated that a child with disabilities with a 33-year life expectancy receiving $1,000,000 in a retirement account would receive $3,200,000 during their lifetime because of additional years of tax-deferred growth. In contrast, a non-EDB receiving distributions under the ten-year rule would only receive $1,300,000 from the same $1,000,000 inherited IRA. For a TPSNT to receive the stretch for the beneficiary's lifetime, the trust must be a "see-through" trust, a topic beyond this article's scope but covered by other *Voice* articles.

- Non-Probate Assets. A TPSNT could be funded with non-probate assets like life insurance or an annuity. If so, the beneficiary designations of these accounts must be changed to the TPSNT. Naming the TPSNT as the beneficiary of a deferred annuity may be advantageous. If the child with disabilities has significant medical expenses, the income received from the annuity passing through the trust could be offset with medical deductions.

Additional Considerations

What other factors should be considered when establishing a TPSNT?

- Testamentary/Standalone. Circumstances may dictate that the TPSNT be a standalone rather than a testamentary trust in a will. Occasionally, third parties such as grandparents will want to fund the trust created by parents and cannot do so with a testamentary trust so long as the parent of the child with disabilities is still living.
- Revocable/Irrevocable. Generally, it would make sense for a TPSNT to be revocable. The only exception would be where the parents establish an irrevocable trust for estate or gift tax purposes or for their own Medicaid eligibility purposes.
- Pooled Trust/Private Trust. Whether the monies to fund the trust would go to a pooled or private trust depends on the amount of money used to fund the trust. In many instances, it is less expensive to utilize a pooled trust. The pooled trust combines several sub-trusts for investment purposes. However, using a pooled trust has limitations, such as the inability to name a trust protector. As a rule of thumb, parents might consider establishing a pooled trust if the amount of the funding is $150,000 or less.
- Trustee Selection. Parents should consider whether a corporate trustee or family member trustee should be named. Corporate trustees include disability organizations, trust companies, and banks. They specialize in the administration of these types of trusts and serve as neutral third parties. Due to the complicated

nature of these trusts, it is often advised not to select a family member to serve as the trustee of the child's TPSNT.

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