Special Needs Trusts Explained: Estate Planning for a Family Member with Special Needs

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Protecting a Loved One's Future: Establishing a Special Needs Trust for a Family Member

Planning for the long-term care and financial security of a family member with disabilities presents a unique challenge. A well-intentioned inheritance, gift, or even legal settlement can inadvertently disqualify the person it is meant to help from critical government benefits such as Supplemental Security Income ("SSI"), Medicaid and related needs-based benefits. One way families will account for this possibility is by establishing a supplemental needs trust (also referred to as "special needs trust") for their loved one. A supplemental or special needs trust, when properly structured, allows families to supplement a loved one's quality of life without jeopardizing their eligibility for needs-based benefits.

Why Direct Gifts and Inheritances Can Backfire

Needs-based benefit programs impose strict asset and income limits on recipients. For example, for an individual to qualify for SSI, they cannot hold more than $2,000 in countable resources. Medicaid eligibility thresholds are similarly restrictive and vary from state to state. When an individual receives an outright inheritance or other lump-sum of money, the funds received become a countable resource for the recipient. Accordingly, the recipient is left with the hard choice to either rapidly "spend-down" the assets to maintain their eligibility for needs-based programs, or lose access to these services.

A Supplemental Needs Trust ("SNT," sometimes referred to as "special needs trust") can help eliminate this dilemma and protect the individual who the trust is meant to benefit (the "beneficiary").

What are Supplemental Needs Trusts?

There are three types of SNTs commonly recommended by estate planning lawyers. The first is a Third-Party SNT, which is funded exclusively with assets belonging to someone other than the beneficiary, such as parents or other family members. You can set up a Third-Party SNT for a loved one during your lifetime. If you wish to leave a loved one a substantial amount of money upon your passing, you can also direct that this gift be funded into a Third-Party SNT for the beneficiary through your Will or Trust. One of the main benefits of setting up a Third-Party SNT is that there is no obligation to pay back Medicaid. Instead, when the recipient passes away, any remaining trust assets can be paid to the remaining beneficiaries that you choose.

The second type is a First-Party SNT, which is funded with the beneficiary's own assets. This type of trust may be set up, for example, when a beneficiary is set to receive a lump sum from a personal injury settlement, an outright inheritance that was not properly planned for, or accumulated earnings. While someone other than the beneficiary must serve as the trustee, the trust can be set up by the beneficiary themselves, a parent, grandparent, legal guardian, or by court order. Further, a First-Party SNT can only be established if the beneficiary is under the age of sixty-five (65) and upon the beneficiary's death, the state must be reimbursed from the remaining trust assets for Medicaid benefits paid on the beneficiary's behalf during their lifetime. Anything remaining after this reimbursement can be distributed to other designated beneficiaries.

Both Third-Party and First-Party SNTs protect the beneficiary because the trust holds legal title to the assets, not the individual it benefits. As such, the funds held in the trust are not counted against the recipient for purposes of determining eligibility for the needs-based programs. Further, aside from drafting, choosing the right trustee for both Third-Party and First-Party SNTs is crucial to ensure your loved one maintains their eligibility to receive benefits, as there are strict compliance rules with respect to the administration of trust assets.

A third option is a Pooled Trust, which is a trust established and managed by a nonprofit organization. Individual beneficiaries maintain separate accounts within the pool, but the assets are pooled for investment and management purposes. Pooled trusts may be funded with the beneficiary's own assets, there is no age restriction, and can be a great choice for individuals who may not have a family member or other willing individual to assist with managing their assets. Upon the beneficiary's death, the nonprofit may retain the remaining funds in the beneficiary's sub-account for its charitable purposes, or the state may seek Medicaid reimbursement depending on applicable law.

The effectiveness of an SNT depends on careful drafting and the relevant state's legal framework. In New York, this is governed by Estates, Powers and Trusts Law ("EPTL") § 7-1.12. Practitioners should ensure that the trust instrument expressly refers to and satisfies the requirements of EPTL § 7-1.12. For example, the trust instrument must make clear that distributions to the beneficiary are intended to supplement, not supplant, public benefits.

Importantly, funds from these trusts cannot be used for any needs that the beneficiary's needs-based programs already cover, such as food and shelter. Instead, the funds in the SNT can be used for items such as recreational activities, education and travel. Practitioners should include language directing the trustee to consider the availability of government benefits to the beneficiary before making any distributions, and the trust instrument must expressly prohibit any distributions that would reduce or eliminate benefits.

Conclusion

A SNT is one of the most powerful tools available to families seeking to provide for a loved one with disabilities without sacrificing access to essential public benefits. To ensure a loved one with special needs is properly protected, families should review their existing estate plans to confirm that no assets pass outright to an individual with disabilities, including wills, revocable trusts, beneficiary designations on retirement accounts and life insurance policies, and payable-on-death designations. Families that take these steps position their loved one to enjoy a higher quality of life both now and later. To discuss the estate planning services outlined in this article, contact estate planning attorneys Gianella L. Marciniak (gmarciniak@lippes.com) or David E. Siegfeld, leader of Lippes Mathias LLP's Trusts & Estates practice team.

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