


STETSON LAW
 2026 Special Needs Trust
 Conference



Tax Basics for Those New to the Internal Revenue Code

Starting from the return you already file, and working toward special needs trusts and ABLE accounts

Presented by:
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1st, a “little” about the speaker



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Benji Rubin (JD/LLM)

Having Mitchell as a brother profoundly shaped who Benji is today, & thus the area of law he chose to practice. His personal experiences as a sibling offer a unique perspective into the responsibilities that come with caring for a sibling with special needs, a concern that he shares with all brothers & sisters of individuals with special needs.




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- Former Director and Treasurer, The Arc of Illinois
- Past President & Director, of S.I.B.S., the Illinois Chapter of Sibling Leadership Network (National Sibling Association)
- Past Chair of the American Bar Association Elder Law and Special Needs Planning Group
- Past Chair of the American Bar Association Special Needs Planning Committee
- Director, Clearbrook Board of Directors
- Director, NSSRA (North Suburban Special Recreation Association) Foundation
- Director, DayOne Pact, trustee of special needs trusts & serves as guardian
- Director, SEDOL (Special Education District of Lake County) Foundation
- Director, Special Needs Alliance, the national, non-profit, membership by invitation, organization of special needs planning attorneys
- Continuing Legal Education Faculty Member (teaching other attorneys) of the Illinois Institute for Continuing Legal Education, as well as for the Illinois State Bar Association, & for the American Bar Association, on the topic of special needs trusts, and special needs legal & future planning

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Special Needs Alliance
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"Legal and future planning for our fellow families of individuals with special needs, including intellectual disabilities, developmental disabilities, and/or mental illness, is not one thing we do, it's the only thing we do; it's not one area of our practice, it's our only area of practice."

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January 27, 1981
MITCH



Worked for Rubin Law







Best Man 8/9/15







MEMBER
SNA
Special Needs Alliance
President 2017-2018

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Growing up as a “Sibling”...

- Helps put things in perspective in life
 - Different than parents...
 - Vacations...
 - Trips to the Store...
- Understanding our future responsibilities



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Benji Rubin

President
S.I.B.S.

Supporting Illinois Brothers & Sisters
Illinois Chapter of the national Sibling
Leadership Network



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The plan for the next fifty minutes

First twenty minutes

What you already know, and what is different

Start with the individual return. Then meet the trust return and work through the four ways it departs from what you are used to.

Next twenty-five

Special needs trusts and ABLE accounts

Which trusts are taxed to the beneficiary, which are taxed to the trust, what to do about it, and how ABLE accounts fit alongside.

Last five

Questions

And whatever did not get answered along the way.

The premise of this session is that trust taxation is not a separate subject. It is individual income taxation with a handful of changes, and if you know the changes you can follow almost any conversation about a trust return.

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PART ONE

From the 1040 to the 1041

What you already know, and the four things that change

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Start with the return you already file

Every income tax computation, for every kind of taxpayer, runs through the same five steps.

1. Add up income

Wages, interest, dividends, rent, business profit, gain on a sale. Everything counts unless a rule says it does not.

2. Subtract deductions

For an individual, the standard deduction or itemized deductions, plus a short list of items taken before that.

3. That leaves taxable income

The number the rate schedule is applied to.

4. Apply the rates

Graduated brackets. Long-term capital gain and qualified dividends get a lower schedule of their own.

5. Subtract credits, add surtaxes

Credits come off the tax dollar for dollar. The 3.8 percent investment income surtax is added here.

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Two things worth pausing on

Not everything is income

The starting rule is that everything is income. The exceptions are specific, and several of them matter in this practice.

– Gifts and inheritances

– Life insurance paid on a death

– Damages for a physical injury, including most personal injury settlements

– Interest on municipal bonds

– Money coming out of an ABLE account for a qualified expense

– SSI and other needs-based benefits

Basis decides how much gain there is

Gain is what you sold it for, less your basis. Where basis comes from depends on how the asset was acquired.

Acquired by	Basis is
Purchase	What was paid for it
Gift during life	Whatever the donor's basis was
Inheritance	Value on the date of death

That third line is the one to remember. Inherited property gets a fresh start, so decades of built-up gain simply disappear. It is available only for property counted in the estate, which is why we will come back to it when we compare first-party and third-party trusts.

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Two kinds of income, two sets of rates

Ordinary income
Wages, interest, rent, business profit, retirement distributions, and gain on something held a year or less. Taxed at the graduated bracket rates. This is the default.

Long-term capital gain and qualified dividends
Gain on something held more than a year, plus most corporate dividends. Taxed at 0, 15 or 20 percent. This is the biggest rate break in the Code.

And a surtax on top of both
An additional 3.8 percent applies to investment income. For an individual it starts at \$200,000 of income, or \$250,000 for a married couple. Hold that number in mind. When we get to trusts, the same surtax starts at \$16,000.

Why anyone cares about the difference
The top ordinary rate is 37 percent and the top capital gain rate is 20 percent. Seventeen points is worth arguing about!

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Now the part that is new: a trust can be a taxpayer

A trust is not a person, but the law can treat it as one. When it does, the trustee files a return called Form 1041, reports the trust's income, claims its deductions, and pays tax out of the trust. It runs through the same five steps you just saw, with its own rate schedule.

Four ways the trust return departs from the individual return

1

The rate schedule is brutally compressed

A trust reaches the top bracket at a fraction of the income an individual needs.

2

The trust gets a deduction for money it pays out

Income that reaches a beneficiary is taxed to the beneficiary instead.

3

Capital gains often stay behind

Even when the trustee sells an asset and hands over the cash.

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Some trusts are not taxpayers at all

The law looks straight through them to a person, who reports everything on a 1040.

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Difference one: the brackets are compressed

A trust

Taxable income	Rate
Up to \$3,300	10%
\$3,300 to \$11,700	24%
\$11,700 to \$16,000	35%
Over \$16,000	37%

A single individual

Taxable income	Rate
Up to \$12,400	10%
\$12,400 to \$50,400	12%
\$50,400 to \$105,700	22%
Over \$640,600	37%

What that means in dollars

A trust is in the top bracket at \$16,000 of taxable income. A single person does not get there until \$640,600. The 3.8 percent surtax follows the same pattern: \$16,000 for the trust, \$200,000 for the individual.

Take \$30,000 of income. A trust that keeps it pays about \$9,030 in federal tax. A person with that same \$30,000 and nothing else pays about \$3,350. Nothing changed except who the taxpayer is. That gap, about \$5,700 a year, is what the rest of this session is about.

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Difference two: paying money out moves the tax

A trust is a taxpayer that gets a deduction for what it distributes. Whatever the trustee pays out, the trust deducts and the beneficiary reports instead. So the trustee has a lever nobody has on a 1040: choosing, within the terms of the trust, whose return the income lands on.

Three things to know about it

- The deduction is capped at the trust's income for the year. Handing over principal does not create a deduction
- It counts as a distribution when the trustee pays someone else for the beneficiary's benefit, not only when cash goes to the beneficiary. Paying a caregiver or a tuition bill counts
- The income keeps its character on the way out. Interest arrives as interest, tax-exempt interest stays tax-exempt

The deadline is not December 31

A trustee can make a distribution in the first sixty-five days of the new year and elect to have it count against the prior year. In practice that means until about the sixth of March to look at the finished numbers and decide how much income to shift onto the beneficiary's return.

Trustees who do not know this rule exist overpay every single year. It is probably the most useful practical thing in this session.

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Difference three: capital gains usually stay behind

Distributing income moves the tax. Capital gain is the exception. When a trustee sells an appreciated asset, the gain is normally treated as belonging to the trust's principal, and it stays taxable to the trust even if the entire proceeds are handed to the beneficiary that same week.

The common surprise

A trustee sells stock to fund a large distribution, assumes the whole thing flowed through to the beneficiary, and finds the gain taxed at 37 percent plus the surtax at the trust level.

When it can be avoided

There are narrow routes to push gain out with the distribution, but they depend on the trust instrument, on state law, and on the trustee handling it the same way every year.

What to do with this

Decide the approach when the trust is funded rather than in the year of the first big sale, write it into the instrument if the trust will hold appreciating assets for decades, and make sure the accountant knows what was decided.

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Difference four: some trusts are not taxpayers at all

For certain trusts the law ignores the trust entirely and treats one person as owning everything inside it. That person reports the income on their own 1040 at individual rates. These are called grantor trusts, and the label is an income tax label only.

What makes a trust a grantor trust

- The person who funded it kept the power to revoke it
- Income can be paid to, or held for, the person who funded it
- Someone kept a power over who benefits, or a power to pull assets out

What it changes

Individual rates instead of compressed ones. The person's own standard deduction and credits apply. Sales between that person and the trust are ignored for tax purposes.

What it does not change

The trust can still be irrevocable, still protect assets from creditors, and still work perfectly for Medicaid and SSI. Grantor trust status is about who pays the income tax and nothing else.

It turns on the powers written into the document, so it is not something the trustee elects year to year.

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PART TWO

Special needs trusts and ABLE accounts

The same four differences, applied to the work you actually do

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Three kinds of trust, three different answers

	Third-party trust	First-party trust (d)(4)(A)	Pooled trust (d)(4)(C)
Whose money	A parent's, a grandparent's, anyone but the beneficiary	The beneficiary's own money. A settlement, an inheritance, back benefits	The beneficiary's own money, in a sub-account of a common fund
Medical payback	None	Required at death	Payback, or retention by the nonprofit
Who pays the income tax	The settlor while it is revocable. The trust itself once it is not	The beneficiary, on their own 1040	The beneficiary, on their own 1040
Counted in the beneficiary's estate	No	Yes	Yes, as to the sub-account

The third row is the whole story. A first-party trust is a grantor trust, so it is taxed to the beneficiary at individual rates. A third-party trust usually is not, so it pays at the compressed rates. Those are two very different problems.

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First-party trusts: taxed to the beneficiary

A first-party trust holds the beneficiary's own money, and trust income can be spent for the beneficiary. That combination makes it a grantor trust, with the beneficiary treated as the owner. Everything is reported on the beneficiary's own Form 1040.

Usually good news

- Individual rates, not compressed ones. No top bracket at \$16,000 and no surtax at \$16,000
- The beneficiary's standard deduction and credits apply. A beneficiary on SSD or SSDI often has little other income, so much of the trust's income is taxed at 10 or 12 percent, or not at all
- If the trust owns the home the beneficiary lives in, the exclusion on the sale of a residence is generally available

Two things to raise with the client

The beneficiary personally owes the tax even though the trustee holds the money, so the document has to let the trustee pay it.

Because it is not a separate taxpayer, this trust cannot use the disability trust exemption on the next slide.

A point of confusion worth heading off

Income being taxed to the beneficiary does not make it countable income for SSI. Tax rules and benefits rules are separate systems, and a tax form does not create a benefits problem by itself.

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Third-party trusts: where the compression hurts

- While the parent is alive and the trust is revocable, nothing separate happens. It is taxed to the parent
- When the parent dies, or when an irrevocable trust is funded, the trust becomes its own taxpayer and the compressed schedule applies
- A \$900,000 trust earning four percent has about \$36,000 of income. Left in the trust, most of it is taxed at 37 percent plus the surtax

Three ways to deal with it

1. Spend the money on the beneficiary

Every dollar the trustee spends for the beneficiary carries income out to a return with much better rates. This is the main tool and it is also, usually, the right thing to be doing anyway.

2. Claim the disability trust exemption

A trust for a disabled beneficiary that meets the requirements takes a \$5,300 exemption instead of \$100. The trustee checks a box on the return. It is worth roughly \$1,900 a year.

3. Change what the trust owns

Tax-exempt bonds, growth assets held rather than traded, and tax-managed funds all reduce the income there is to argue about.

The exemption requires an irrevocable trust for a beneficiary who was under 65 when it was established and who SSA has determined to be disabled. Details in the materials.

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Spending: the tax rules and the benefits rules disagree

The tax rules reward the trustee for paying money out. The benefits rules restrict what can be paid, to whom, and in what form. Living with both is most of the trustee's job.

The tax side

Anything the trustee pays for the beneficiary's benefit moves income onto the beneficiary's return, where the rates are far better. Paying a caregiver, a dentist, a tuition bill or a therapist all count.

The SSI side

- Cash to the beneficiary reduces the check almost dollar for dollar
- Food or shelter paid on their behalf reduces it by a capped amount
- Medical, dental, transportation, recreation, education, phone and personal care generally do not affect it at all

Where they agree, and where the real failure happens

The spending that serves the beneficiary best is usually the spending that produces the deduction. A trustee actively using the trust generates the tax benefit as a byproduct.

The problem case is the cautious trustee who accumulates for fifteen years, pays the top rate every one of them, and leaves a smaller trust than the parents intended. Review the tax position and the benefits position in the same meeting, and use the sixty-five day rule to make the final call once the numbers are in.

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What happens at death

First-party trust

The money was the beneficiary's and they had the benefit of it for life, so it counts in their estate. That means the assets get a fresh basis at death and decades of built-up gain disappear.

Third-party trust

The beneficiary never owned the assets, so nothing is counted in their estate. That is usually the point.

With the estate tax exemption at \$15 million, being counted in the estate costs almost nothing and the basis reset is a real benefit.

The cost is that appreciated property carries its old basis to whoever takes it next. Worth asking whether the trustee should realize some gain during life, or whether the document should be drafted differently.

Two more things about the end of a trust

The payback to the state in a first-party trust comes before any remainder passes, and paying it does not generate a deduction.

A retirement account left to a special needs trust can still be stretched over the beneficiary's life expectancy rather than the ten-year rule that hits most trusts post Secure and Secure 2.0. Where an IRA is going to one of these trusts, review the beneficiary designation and the trust language together, while the account owner is alive.

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ABLE accounts

What it is

- A savings account for a person with a disability, run through a state program, modeled on a 529 college account
- Money goes in after tax, grows without tax, and comes out tax-free if spent on a qualified disability expense
- One account per person. Most states will take out-of-state residents

What counts as a qualified expense

Education. Housing. Transportation. Employment training. Assistive technology and personal support. Health and wellness. Financial management. Legal fees. Funeral and burial. Basic living expenses.

The standard is anything related to the disability that helps maintain or improve health, independence or quality of life. It is far broader than most families assume, and broader than most expect.

Why it matters for benefits

- Up to \$100,000 in the account is ignored for SSI, against the usual \$2,000 resource limit
- For Medicaid the balance is generally ignored without that cap
- Money spent on qualified expenses other than housing is not income

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ABLE in 2026, and what just changed

The numbers

	2026
Contribution limit, all sources combined	\$20,000
Gift tax annual exclusion, for comparison	\$19,000
Extra amount a working beneficiary can add	Up to \$15,650
Tax credit for a beneficiary's own contributions	Up to \$1,000
Balance ignored for SSI	\$100,000
Disability must have begun before age	46

What changed this year

- The onset age moved from 26 to 46 on January 1, which made several million more people eligible
- The contribution limit is no longer the same number as the gift tax annual exclusion
- The work contribution, the tax credit and rollovers from a 529 account were all going to expire and were made permanent

Worth flagging to anyone who funds these accounts

For twelve years the ABLE limit and the gift tax annual exclusion were the same figure and everyone used them interchangeably. They are now different. A donor who funds an account to the \$20,000 maximum has made a \$20,000 gift, has used \$1,000 of lifetime exemption, and owes a gift tax return. At today's exemption that costs nothing, but the return still must be filed.

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Using an ABLE account alongside a trust

	ABLE account	Special needs trust
How much it holds	\$20,000 a year, and \$100,000 before SSI is affected	No limit
Who controls it	The beneficiary, with a debit card (unless there is a Guardian/Conservator)	The trustee
Tax on the earnings	None, if spent on qualified expenses	Compressed rates, or the beneficiary's rates if a grantor trust
Housing	Fine if paid directly.	Generally reduces the SSI check by 15M (up to 1/3)
Cost to set up and run	An online account and small fees	Drafting, trustee fees, annual returns
Payback at death	Possible, though several states have declined to enforce it	Yes for a first-party trust, none for a third-party trust

The structure that usually works for beneficiaries who are more independent

Keep the bulk of the money in a third-party trust, where there is no payback and no ceiling. Size the ABLE account to near-term spending and have the trustee refill it each year. The beneficiary gets real independence, the corpus stays protected, and the annual transfer is a distribution that carries income out to a better rate schedule.

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Six things to take with you

1. A trust return runs through the same five steps as your 1040. Four things change, and that is the whole framework.
2. A trust is in the top bracket at \$16,000 of income. A person is not until \$640,600.
3. Money the trustee spends for the beneficiary moves the income onto the beneficiary's return, where the rates are far better.
4. The trustee has until about March 6 to decide how much of last year's income to move. Most trustees do not know this.
5. A first-party trust is taxed to the beneficiary at individual rates. A third-party trust pays its own tax at the compressed rates.
6. ABL accounts changed this year: onset before 46, a \$20,000 limit, and no longer tied to the annual exclusion.

Questions

The written materials carry the full outline, the Code sections behind everything discussed here, and a source list for the 2026 figures.

The 2026 numbers from this session	
Trust top bracket and surtax begin	\$16,000
Ordinary trust exemption	\$100
Disability trust exemption	\$5,300
Gift tax annual exclusion	\$19,000
Estate tax exemption	\$15,000,000
ABLE contribution limit	\$20,000
ABLE balance ignored for SSI	\$100,000
SSI monthly benefit, individual	\$994
SSI resource limit, individual	\$2,000

Offered for educational purposes. Not legal or tax advice, and not intended or written to be used for the purpose of avoiding penalties. Figures are 2026 amounts and are adjusted annually.
