

Nuts and Bolts of Third Party Special Needs Trusts (Basics)



Amy C. O'Hara, CELA
Partner
Littman Krooks LLP
New York

www.littmankrooks.com

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Americans with Disabilities

More than 56 million Americans living with a disability
which make up 19 % of U.S. population

1 in 6 (or about 17%) of children ages 3 to 17 have
one or more developmental disabilities

1 in 44 children have autism (1 in 27 boys, 1 in 116 girls)

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The Snyder Family

Tom and Barbara Snyder meet with you to discuss their estate planning. They have three children: Maggie, Jennie and Katie. Maggie and Jennie are neurotypical adults. Katie, is 27 years old and diagnosed with schizoaffective disorder. Katie has never been able to work and receives SSI and Medicaid benefits. She is in the process of moving to supportive housing.

Tom and Barbara's assets consist of a house valued at \$1,000,000, retirement accounts totaling \$2,000,000 and investments totaling \$1,000,000

Their testamentary goals are to equalize the distributions for their daughters but understand Katie has extraordinary care needs.

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Estate Planning Options for Snyder Family re: Katie

Disinherit Katie

Leave assets outright to Katie

Distribute Katie's share to Maggie and Jennie

Distribute to an ABLE Account for Katie

Create a third party SNT for Katie



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What is a Third Party SNT

Trust established by a third party with assets of a third party for the benefit of a person with a disability (Katie)

No federal statute; some state statutes

Discretionary trust, no ascertainable standard (health, maintenance and support)

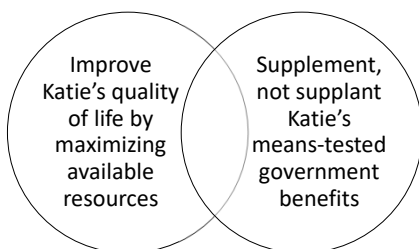
Trust assets are exempt and not countable as Katie's assets

No age requirement

No Medicaid payback (Tom and Barbara choose remaindermen)

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Purpose of Third Party SNT



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Goals of Third Party SNT

- Provide money management, prudent investments
- Control distributions and avoid financial exploitation
- Allows Katie to not be “disinherited” and maintain eligibility for public benefits
- Provides for Katie even if public benefits are curtailed or eliminated

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Settlor’s Intention – Excerpt

The Settlor believes it to be in the best interest of Katie to establish this Trust with discretionary provisions to enhance the Katie’s quality of life both now and in the future by providing for her needs. The Settlor intends that this Trust will provide benefits to supplement those which may otherwise be available to Katie from various sources, including insurance benefits and governmental entitlement programs. It is the Settlor’s intention that Katie receive all government entitlements to which she would otherwise be entitled but for the existence of this Trust and distributions hereunder. The purpose of the Trust is to permit the use of the Trust Estate to supplement and not supplant or diminish any benefits or assistance of any federal, state or other governmental entity for which Katie may be eligible or which she may be receiving unless the Trustee in the Trustee’s sole and absolute discretion determines the benefit of a distribution of the Trust Estate outweighs a potential impact on government entitlements.

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Third-Party SNTs

Testamentary

- Irrevocable

Inter vivos

- Revocable; or
- Irrevocable

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Testamentary Third Party SNT

- Created under Last Will and Testament
- Not established and cannot be funded until testator's death and then need to wait for probate
 - Typically, last to die between Tom and Barbara
- Can be more difficult to name as beneficiary on retirement accts and life insurance
- Irrevocable
- Court oversight - depending on state
- Court proceedings generally required to modify trust or change trustee
- Despite disadvantages, only option for planning for spouse

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Intervivos Third Party SNT - Revocable

- Revocable to settlor, not beneficiary
 - Trust becomes irrevocable upon settlor's death
- Allows flexibility for settlor to remain trustee
- Allows flexibility to make amendments as beneficiary's needs change
- Not recommended for estate and gift tax planning or if other people want to make contributions
- Any funding while trust is revocable is includable in settlor's estate and settlor pays income tax on trust income; basis step up at death

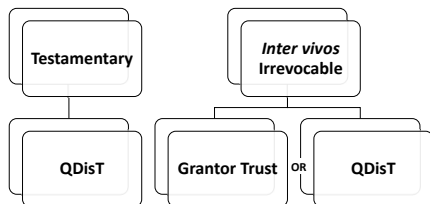
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Intervivos Third Party SNT - Irrevocable

- Often used when engaging in estate and gift tax planning
 - Do not give beneficiary Crummey withdrawal powers or general power of appointment
- Recommended when other individuals (not including settlor or settlor's spouse) want to make gifts to beneficiary
 - Grandparents, other family relations, friends
- Settlor should not be trustee

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Third-Party SNTs – Irrevocable Income Taxation



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Third-Party SNTs – Qualified Disability Trust

- If a third party SNT can meet the statutory requirements of Qualified Disability Trust (QDisT), it is allowed a personal exemption (\$5,000 in 2024)
- But wait – I thought the Tax Cuts and Jobs Act of 2017 eliminated personal exemptions through 2025? It does – except for a QDisT
- IRC § 642(b)(2)(C)
- A grantor trust cannot be a QDisT
- If trust is not a grantor trust and does not qualify as QDisT then treated as complex trust with \$100 exemption

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Third-Party SNTs – Qualified Disability Trust

Statutory Requirements - see 42 U.S.C. § 1396p(c)(2)(B)(iv); third party SNT must be:

- Irrevocable
- For the sole benefit of the beneficiary with a disability
- Beneficiary must be under age 65 at time trust is established
- Beneficiary must have a disability as defined for purposes of SSI and/or SSDI programs

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What can a Third Party SNT



Short answer... pretty much anything provided it is consistent with trust terms and for beneficiary's benefit



No cash distributions to beneficiary



Caution as certain distributions, such as shelter costs, can cause a reduction in certain benefits

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A Primer on Income

What is Income?

- Benefits income is not the same as taxable income
- This concept is often confused by Social Security and Medicaid workers and special needs attorneys often need to educate them about their own rules

Taxable Income

- For purposes of trusts and taxable income, distribution of income is either distribution directly to or for the benefit of the beneficiary

Benefits Income

- For purposes of "needs based" benefits, income is cash, or anything that can be used for shelter unless it is exempt.

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Third-Party SNTs – Income Example

Benefits Income \neq Taxable Income

If the trustee of Katie's third party SNT pays her telephone bill directly from the trust, Katie has received a benefit and therefore has received taxable income to the extent it is made up of DNI.

In this example, Katie did not receive any income for benefits purposes because she did not receive cash or shelter.

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Third-Party SNTs – Income Example

Benefits Income \neq Taxable Income

If the trustee of Katie's third party SNT pays her rent directly from the trust and she receives SSI, Katie has received a benefit and therefore has received taxable income to the extent it is made up of DNI.

In this example, Katie will lose 1/3 of her SSI benefit as the payment of shelter is considered income to the beneficiary.

NOTE – ABLE ACCOUNTS CAN BE USEFUL HERE TO ELIMINATE 1/3 REDUCTION

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Fair is Not Always Equal

What are the client's family circumstances?

Consider beneficiary's lifelong needs and abilities or inabilities

Permanent life insurance

Retirement account allocation

Have flexibility to change plan as family ages

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Be Flexible in Drafting

Third party SNTs often last beneficiary's entire lifetime and their needs will likely change as they age

- Authorize trust amendments
- Allow change of situs
- Trust Protectors can be key
- Decanting

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Choosing the Right Trustee

Carefully consider trustee – will they, can they do their job?

- Beneficiary's disability
- Potential conflict of interest?

Proper education of role and responsibilities

- Complexity of government benefit regulations
- Have a team!

Replacement and appointment flexibility

- Trust Protector?

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A Few Cautions...

DO NOT:

- Make third party gifts to first party SNT
- Not create third party SNT for someone 65 or older
- Include 42 U.S.C. § 1396p(d)(4)(A) language or citation references in third party SNT
- Require mandatory distributions of income or principal or include a standard so beneficiary can demand distributions (think HEMS)
- Give SNT beneficiary a Crummey withdrawal powers or general power of appointment
- Spend third party SNT assets prior to first party SNT assets (if possible)
- Give SNT beneficiary cash distributions (or deposits into their personal bank account)
- Include Medicaid payoffback in third party SNT

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Contingency Planning

Contingent SNTs in all Wills and Trusts

Coordinate other relatives' planning

Dear Family and Friends Letter

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Avoid Knee Jerk SNT



Means-tested benefits are not always necessary



Allow distribution of income



Can include trigger to third party SNT if benefits are required

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Thank You!



Amy C. O'Hara, CELA
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