Funding Strategies for Special Needs Trusts

By Minoti Rajput

April xx, 2020

Advisor Perspectives *welcomes guest contributions. The views presented here do not necessarily represent those of* Advisor Perspectives*.*

When parents start the planning process for a child with special needs, they usually work under the perception that if they create a special needs trust (SNT), the child will be taken care of and the needs will be met. Unfortunately, creating a trust does not ensure that. Funding the trust is just as important as creating it. In addition, parents always have to be mindful of the stability and security of their own financial planning in the entire process of funding the SNT.

Parents must keep a record of how much they spend on their child now and projectthe child's expenses in the future. Weigh in on what expenses the child may have that will *not* be covered by the government. Parents may take into consideration the aging process of the child, possible medical conditions that may require special attention, and the potential inadequate government resources. This will provide a detailed picture of the child's needs and the amount of money needed to fund the SNT. In the end, however, planning for the SNT, funding should be done based on the parent's ability to pay for it.

For many families, it may not be practical to count on a portion of the remaining estate of the parents to fund the SNT. The parents may need their assets for their own retirement, possible long-term care and may not have much left by the time they pass away. SNTs may be funded during the parent's lifetime, but most trusts are generally funded after the parents pass away. Most families take care of the financial needs of their child with special needs while they are alive, the need to fund the trust is mainly afterthe parents have passed on. Permanent life insurance is often used as a product that ultimately funds the SNT. Life insurance is an asset that is created on a leveraged basis and the death proceeds are income tax-free.

The asset mix for most families is a combination of retirement assets, non-retirement (after-tax assets), and the family home. In determining the best way to divide their remaining assets between their children including the SNT, parents may need to be educated on tax implications for the assets at the time of distribution. Until recently, the retirement assets were typically recommended to be distributed to the family's other children for their ability to stretch the assets based on their life expectancy. The Secure Act tax law change, passed in December 2019, no longer allows the stretch to children inheriting the parent's retirement assets. It will be needed to be distributed in 10 years, at the cost of expensive taxation.

A person with a disability, on the other hand, maybe able to stretch an inherited retirement asset over their life expectancy. Since the person with a disability will typically have their assets held in a SNT, a trust with the right language ('See- Through' language), will be able to provide for the stretch of the assets, which may be more tax-efficient, depending upon the income needs of the person with disability.

One of the most common assets to fund a SNT is a permanent life insurance policy on the parents. Life insurance allows creation of an asset on a leveraged basis, providing tax-free death proceeds, and is a practical approach to funding the trust.

Revocable SNTs become irrevocable upon both parent's deaths. Irrevocable trusts are tax-paying entities and are taxed at a higher rate. Investment management of assets in this type of trust has to be done carefully to achieve maximum tax efficiency.

Planning for the secure future of a person with a disability requires a team of professionals. Periodic reviews are a must for the best results to keep your plan current. Changes will continue to take place in the future such as tax laws, government benefits as well as in family dynamics. Your wealth advisor, estate planning attorney, and CPA have to be well-versed on special needs planning matters for the best results and a secure future for your loved one.

Minoti Rajput, CFP, ChSNC, is the founder and principal wealth advisor of Secure Planning Strategies. She has been working with families with children of special needs for over 30 years and is a frequent speaker on various topics related to special needs planning. She is also the author of ***Beyond a parent's Love*** .