Estate Planning for People with Special Needs

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Introduction

When planning for families with children who have special needs, whether those children are minors or adults, strategic financial and estate planning is *essential* – including the creation of a trust to protect the child's government benefits and to ensure the child with special needs has the resources available to maintain the standard of living to which he or she is accustomed.

Will vs. Living Trust

Your will sets forth the disposition of your estate upon your death and can include the creation of testamentary trusts upon your death for beneficiaries with special needs. In addition, your will designates the personal representative (a/k/a "executor") of your estate and states your preference as to the guardians for your children. It is important to note that, if you are depending on your *will* to transfer your assets, a probate proceeding will be required to administer your estate upon your death.[1] As an alternative, you may want to consider creating a revocable living trust.

A revocable living trust (also known as an "inter vivos" trust) is an estate planning tool used primarily to establish who will manage your assets during your incapacity and how your property will be distributed upon your death. Most living trusts are "revocable" because you retain the power to amend them as your circumstances or wishes change. Revocable living trusts are "living" because they are created and become effective during your lifetime.

Generally, one of the primary purposes of creating a revocable living trust is to avoid the necessity of a probate proceeding upon your death. Upon your death, any asset titled solely in your name, with no direct beneficiary designation, is typically subject to the probate process[2] –

[1] Note that under Wis. Stat. § 853.34(3), if a trustee of a trust created by a testator's will is designated as the beneficiary of a transfer under another governing instrument, at the death of the testator or at the death of a third party, the transfer of any assets under that other governing instrument to the trustee does not cause the transferred assets to be included in the property administered as part of the testator's estate. The transferred assets are not subject to taxes, debts, or charges enforceable against the testator's estate to any greater extent than if the proceeds were payable to a beneficiary other than the testator's estate.

[2] Wisconsin has a procedure allowing any heir of the decedent, trustee of a revocable trust created by the decedent, or person who was guardian of the decedent at the time of the decedent's death to use an affidavit to transfer estate property without more formal probate procedures or court involvement. This affidavit procedure is available when a decedent leaves property subject to administration in this state which does not exceed $50,000 in value. See Wis. Stat. § 867.03.

even if you have a valid will in place. Probate is the court-supervised process of validating your will, if you have one, of ensuring your final debts and expenses are paid and then distributing the remaining probate estate to the beneficiaries name in your will or to your heirs at law if you have no valid will in place (i.e., you died "intestate"). Probate can be expensive and time consuming, and is generally a *public* court proceeding. If you own real estate in multiple states, a separate probate proceeding in each state in which you hold property at the time of your death is often necessary. Property owned by your revocable living at the time of your death will pass according to the terms of your trust, *without the necessity of a probate proceeding*.

The three primary positions of a trust are:

1) The grantor (also known as a "trustor" or "trustmaker"), who creates the trust and transfers his or her assets into the trust (can be a single grantor or joint grantors);

2) The trustee, who manages the assets owned by the trust (can be a single trustee or joint trustees); and

3) The beneficiaries: The lifetime beneficiaries receive the benefit of the assets in the trust during the grantor's lifetime (generally this is the grantor himself or herself, along with anyone who is dependent upon the grantor) and the death beneficiaries receive the assets in the trust upon the grantor's death.

A revocable living trust agreement is a written document, signed by the grantor(s), typically in the presence of two witnesses and a notary public (note that legal requirements of a validly executed trust document vary from state to state). The agreement should name an initial trustee and successor trustees in the event the grantor becomes incapacitated and upon the grantor's death. The agreement should also specify how the property in the trust will be distributed upon the grantor's death. Beneficiaries can include individuals and/or charities, and can specify *how* each beneficiary's share is to be distributed. For example, the trust language can create separate trusts to protect beneficiaries with special needs.

After the trust agreement is created, the grantor must transfer any property he or she wants managed and distributed under the terms of the trust into the name of the trust – this is known as the *funding* process. The funding process must be done properly and thoroughly, or the property could wind up in probate. An <u>effective</u> funding process involves:

1) Transferring all bank accounts into the trust (many banking institutions do not require new account numbers, new checks or new debit cards);

2) Transferring all non-retirement investments into the trust (note that tax-deferred assets will be addressed later in this presentation);

3) Drafting and recording deeds transferring the grantor's ownership interest in all real estate (including oil and mineral interests) into the trust;

4) Transferring vehicle and boat titles into the trust, when appropriate;

5) Assigning all tangible personal property to the trust;

6) Naming the trust as the beneficiary of most life insurance policies and some annuities (depending on whether or not the annuity has any tax-deferred component); and

7) Transferring business interests to the trust, when appropriate. For example, often the grantor's membership interest in a limited liability company can be assigned to the trust and the grantor's interest in a corporation can be transferred to the trust by virtue of new stock certificates. However, a thorough review of each corporate book will be necessary.

Pour-Over Will: A "pour-over will" is a last will and testament that is designed to capture any assets that are not properly titled in the name of a revocable living trust. As explained previously, upon your death, any asset titled solely in your name, with no direct beneficiary designation, is typically subject to the probate process. A will is the only legal means to designate guardians for children. Therefore, *even if the client has a revocable living trust in place*, it will still be necessary to draft a pour-over will.

Types of Special Needs Trusts and Their Specific Purposes

If you name an individual with "special needs" (i.e., a person who is receiving a governmental benefit such as Supplemental Security Income (SSI) or medical assistance based on a disability) as a direct beneficiary, you could unintentionally disqualify that individual from receiving his or her valuable governmental benefits. The individual must then "spend down" the inheritance and, after virtually all the money has been spent, go through the application process again. If you wish to leave an inheritance for a loved one who is receiving this type of assistance, it is much better to create a "special needs trust," also known as a "supplemental needs trust," within your will or living trust to hold the inheritance for the benefit of that individual for his or her lifetime without jeopardizing his or her benefits.

Note that a special needs trust can also be structured as a "stand-alone" trust (rather than a trust designed to spring into existence through a will or living trust only upon the death of the testator or grantor) if other relatives wish to set aside funds for the benefit of the individual with special needs.

"First-party" Special Needs Trusts

First-party special needs trusts are irrevocable trusts designed to benefit individuals with disabilities who qualify for public benefits available only to individuals with limited resources (such as SSI or Medical Assistance), or who might qualify for these benefits at some point in the future. They are funded with the assets of the disabled individual.

This type of trust allows assets to be set aside for "supplemental" expenses not covered by the available public benefits. For example, a trustee can distribute funds from the trust to pay for expenses such as community supports, recreation and leisure, housekeeping services, transportation, and educational and training but cannot use the trust assets to pay for basic expenses such as food or shelter which are covered by SSI.

The beneficiary of a first-party special needs trust must be under age 65 at the time the trust is established.

Upon the beneficiary's death, the state Medicaid agency must be reimbursed; this is known as a "payback" requirement.

A first-party special needs trust may be desirable when an individual with special needs has assets, or expects to receive assets in the future such as an inheritance or a lawsuit settlement, that would disqualify him or her from eligibility for public benefits.

"Third-party" Special Needs Trusts

Third-party special needs trusts are established by a donor – the person who contributes the funds to the trust.

This type of trust can be an inter vivos trust (i.e., established during the donor's lifetime) or as part of the grantor's estate plan (e.g., under a will or a revocable living trust).

Third-party special needs trusts have no age limits.

There is no limit to the value of the trust assets and, *unlike a first-party special needs trust*, upon the beneficiary's death the assets in a third-party special needs trust can pass to the donor's remainder beneficiaries with no payback requirement.

The Program Operations Manual System ("POMS"), which is the manual used by SSA employees to administer Social Security and Supplemental Security Income, provides that if the beneficiary of a third-party special needs trust does not have the legal authority to revoke or terminate the trust, or to direct the use of the trust assets for his or her own support and maintenance, then the trust assets are not an available resource to the beneficiary for purposes of means-tested benefits.

"Pooled" Special Needs Trusts

Pooled special needs trusts, such as Wispact trusts in Wisconsin (see www.wispact.org), are established and managed by a nonprofit association, usually a charitable entity organized under section 501(c)(3) of the Internal Revenue Code.

Pooled special needs trusts are available to disabled individuals of any age.

A separate account is maintained for each beneficiary of the trust. However, for investment and management purposes, the various accounts are pooled (hence the name "pooled" trust).

The pooled trust sub-account must be established by the beneficiary's parent, grandparent or guardian, by the court, or by the person with the disability.

Upon the death of the beneficiary, the balance remaining in the account (unless the account is considered a "third-party" trust), if any, may be retained by the charity establishing the pooled trust, to be used for other beneficiaries of the pooled trust. A few states have required that some or all of the trust funds remaining at the death of the beneficiary be repaid to the state Medicaid agency, but most states allow the beneficiary to elect that the charitable organization retain the balance at the beneficiary's death.