

The Weekly Scenario: Setting Up Special Needs Trusts

July 9, 2021

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Planning for beneficiaries with special needs can be a challenge. While navigating the requirements for both IRA beneficiaries and trusts has never been without pitfalls, the more recent requirements of the SECURE Act have added even more wrinkles.

The goal of the Special Needs Trust is to protect the funds for a person with special needs while not jeopardizing any government benefits to which the individual may be entitled. The trustee can make distributions to the beneficiary with special needs for vacations, food, housing and other personal items to improve and enhance their lives. The goal is not to jeopardize the current and future potential benefits.

Under the SECURE Act, beneficiaries with special needs who qualify as disabled or chronically ill are eligible designated beneficiaries (often referred to as “EDBs”) and can still take advantage of the stretch IRA. Under the SECURE Act, there are certain rules that specifically preserve the lifetime stretch for beneficiaries who are chronically ill or have a disability through a trust called a Multi-Beneficiary Trust (MBT). As the name implies, the MBT may have multiple beneficiaries of the trust, in addition to the person with a disability. These other beneficiaries must be designated beneficiaries but do not have to be an eligible designated beneficiary. Examples of designated beneficiaries include other children or siblings (but not a charity or an estate).

For example, if Mark creates a special needs trust for the benefit of his daughter with a disability and names the trust as beneficiary of his IRA, and the trust provides that any remaining funds from the IRA be paid to a charity, the trust would not qualify as a multi-beneficiary trust. As such, the minimum required distributions will not be permitted to be stretched over the child's life expectancy (instead, the 10-year rule would be applicable).

However, while these multi-beneficiary trusts are beneficial from a stretch point of view, special needs trusts can be problematic from an income tax standpoint. Because trust tax brackets are highly compressed (reaching the highest income tax rate at fairly low levels), funds retained in the trust will be subject to high trust tax rates.

It is for this reason that it is beneficial to explore exchanging assets like traditional IRAs for more tax-efficient assets like Roth IRAs and life insurance. Employing alternative strategies can mitigate the tax bite while providing a source of funding for special needs trusts.

As always, if you have any questions or would like to learn more, please contact Steve Shane at sshane@offitkurman.com or [301.575.0313](tel:301.575.0313).