

# ADVANCED PLANNING BULLETIN

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## Individuals with Special Needs Can Now Establish Their Own Self-Settled Special Needs Trusts

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### Summary

New language added to an existing federal statute enables individuals with special needs to create their own self-settled special needs trust.

### Related Information

[Planning for Beneficiaries with Special Needs in brief](#)

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A recent change to a well-established federal law on special needs trusts enables individuals with special needs to create their own first-party special needs trust.

### Background

Special Needs Trusts (SNTs) play an important role in enhancing the financial security and quality of life for an individual with special needs. Many government programs that help those with special needs – such as Medicaid or Supplemental Security Income (SSI) – are “means tested,” in that they are available only to people with low income and minimal assets. Having a relatively small amount of income or assets can often disqualify someone from these governmental programs, even if that amount of income or assets is not really enough to take care of the individual’s special needs.

A properly drafted SNT alleviates this difficulty somewhat, as it allows the individual to benefit from resources inside the trust while still qualifying for government assistance programs. There are three basic types of special needs trusts: (i) first-party SNTs, (ii) third-party SNTs, and (iii) pooled trusts. All three of these trusts manage assets for a beneficiary with special needs in a way that enables the beneficiary to qualify for public benefits.

1. First-party SNT. First-party SNTs (also known as self-settled trusts) hold assets that previously belonged to a special needs individual that would otherwise disqualify him or her from continuing to receive public benefits. Examples include an inheritance or settlement proceeds from a lawsuit. If these assets are transferred into a properly drafted self-settled SNT, the assets will not disqualify the individual from continuing to receive government assistance. Upon the death of the individual with special needs, any remaining assets in the self-settled SNT must be used to repay Medicaid for the cost of care it provided to the individual. For this reason, the self-settled or first-party SNT is often referred to as a “payback trust”.

2. **Third-party SNT.** Third-party SNTs are designed to receive gifts and inheritances from the grantor (such as a parent) and other family members. During the beneficiary’s lifetime, the assets in the SNT are used to supplement the beneficiary’s government benefits. Third-party SNTs must be carefully drafted and administered to avoid disqualifying the beneficiary from receiving government assistance. Upon the beneficiary’s death, any remaining assets can pass to other family members or remainder beneficiaries. Because the assets never belonged to the beneficiary with special needs, there is no “payback” requirement. Special Needs Trusts can be complex, and many trust companies charge extra fees to administer them or will not serve as trustee.
  
3. **Pooled Trust.** A pooled trust is a type of SNT where the beneficiary’s assets are managed as part of a group trust. Commonly known as “community” or “master” trusts, pooled trusts are managed by nonprofit organizations. Participating in an already-established pooled trust is inexpensive, as no new trust needs to be drafted. The assets from a number of individual beneficiaries with special needs are combined and invested together, reducing the cost of administration and management. A separate subaccount is established for each individual member to keep track of the funds being allocated to each individual beneficiary. Upon the death of the beneficiary, most states require that any funds remaining in the subaccount be used to reimburse the government for any medical payments provided to the beneficiary. However, some states allow the non-profit administering the pooled trust to retain some or all of the remaining funds to support other beneficiaries in the pool.

**So what changed?**

The law authorizing the establishment of a first-party or self-settled SNT was enacted in 1993.<sup>1</sup> Under the first version of the statute, a qualifying self-settled SNT could only be established by a parent, grandparent, guardian, or court. In other words, individuals with special needs were prohibited from establishing their own self-settled SNT, even if they had the capacity to do so. This forced the individual to rely on others to create the trust, and was especially burdensome for those who did not have a living parent or grandparent, essentially forcing an expensive court proceeding. Many organizations advocated for a change in this law as it didn’t grant capable individuals the independence to make their own decisions in establishing these trusts.

This deficiency was recently rectified with the passage of the 21st Century Cures Act.<sup>2</sup> Section 5007 of the Act, entitled “Fairness in Medicaid Supplemental Needs Trusts” added two words to the 1993 statute: “the individual.” This change permits these individuals to create their own self-settled SNTs without having to rely on family members or go to court. Of course, an experienced special needs attorney should still be involved in the preparation of a SNT.

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<sup>1</sup> 42 U.S.C. § 1396p(d)(4)(A).

<sup>2</sup> H.R. 34-114<sup>th</sup> Congress (2015-2016).

## Providing for a lifetime of financial security with permanent life insurance

Permanent life insurance is an important funding source for third-party special needs trusts. Individuals with special needs are often taken care of by parents. Once a parent is no longer there, someone needs to fill that role. Siblings are often busy raising their own families and are unable to fill that gap. Supportive persons may need to be hired. Naming the third-party SNT the beneficiary of a life insurance policy on the life of a parent ensures that the funds are there when that need arises. A permanent life insurance policy provides the family with the comfort of knowing that even if there are financial setbacks, the SNT will be adequately funded. With proper planning, your client can rest assured that his or her loved one with special needs will have the funds necessary for a lifetime of financial security.

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