Morgan Stanley

Planning for Individuals With Special Needs

Estate Planning

Wealth and Estate Planning Strategists
Family Office Resources

Individuals planning for their own financial well-being or the financial well-being of a family member with special needs face several challenges. They must design their financial and estate plan so that it provides for special needs without:

- Depriving other family members of a meaningful inheritance;
- Placing other family members in a position of responsibility that they may not be prepared or willing to assume;
- Rendering their family member with special needs ineligible for government benefits like Supplemental Security Income (SSI) and Medicaid.

For families wrestling with these complex issues, a special needs trust can prove to be a viable solution.

CONTEMPLATED ACTION	POSITIVES	NEGATIVES
Direct gift or bequest	• Simplicity • No cost to implement	• Individual may not be capable of managing assets • May result in ineligibility for government benefits
Direct gift or bequest to family member to provide for another individual with special needs	• Simplicity • No cost to implement • Individual with special needs remains eligible for government benefits	• Requires family member's commitment • Assets may be at risk if family member faces litigation or divorce
Special Needs Trust	• Individual with special needs remains eligible for government benefits • Your wishes are implemented as intended • Minimizes family conflict and turmoil • Assets can be managed according to your wishes	• Requires services of an estate planning attorney • Requires services of an independent trustee • More expensive to implement

First Steps

Like any trust, a special needs trust is typically established by a grantor for the benefit of a beneficiary— in this case, your family member with special needs. As the grantor, you appoint an independent trustee to ensure that the provisions of the trust are carried out as you intended.

There are different types of special needs trusts. You can consider a first-party special needs trust, a third-party special needs trust, a first-party pooled special needs trust and a third-party pooled special needs trust. A first-party special needs trust is funded with property that the special needs trust beneficiary provides, for example, from a financial settlement from an accident, and Medicaid has the right to claim the balance of the first-party special needs trust when the beneficiary passes away. A third-party special needs trust is funded with property owned by a third party. Medicaid has no claim on the balance of a third-party trust when the beneficiary passes away.

You can join a pooled trust by signing a joinder agreement with a specific non-profit organization. Pooled special needs trusts are managed by 501(c)(3) organizations on behalf of many individual beneficiaries with disabilities. Typically they can be funded with a lower dollar amount of fewer assets than an individual special needs trust, though they are typically less flexible regarding distribution schedules, trustees, and fees.

Your family member should never receive a direct distribution from the third-party trust. In fact, the trust document may specifically prevent trustees from making direct distributions to the individual with special needs. Rather, assets can be distributed directly to health care, social service or education providers, thereby enabling you to pay for these services without actually giving income to your family member.

Safeguarding Benefits

Government benefits are available to help individuals with special needs who require assistance to meet and provide for their food, shelter, health care and other living expenses. When these individuals are under the age of 18, their eligibility for benefits is based on their parents' income and assets. Once they reach the age of majority, however, their eligibility is based on their own income and assets. As a result, leaving assets or distributing income directly to beneficiaries with special needs can disqualify them from receiving government benefits that provide basic life necessities and that could enhance their lives.

With a special needs trust, your family member will maintain eligibility for governmental benefits. What's more, the special needs trust can supplement those benefits with resources that will enable your family member to enjoy a better standard of living.

Special needs trusts also enable you to:

- Direct how assets will be managed, thereby relieving your other family members or beneficiaries of responsibilities that he or she might not be able to assume;
- Protect assets from creditors or litigation; and
- Create a succession plan for any assets remaining in the special needs trust after the death of the special needs beneficiary.

How to Fund a Special Needs Trust

Like any trust, special needs trusts can be funded with stock, real estate or other assets. Most special needs trusts are funded with liquid assets such as cash and stock. For some grantors, especially those who would like their family members to have a higher standard of living, life insurance may be a preferable choice.

Unlike assets that fluctuate in value, life insurance generally offers the ability to leave your family member a designated amount. In addition, the death benefit provided by life insurance will be received income tax free by the special needs trust.

Life Insurance Considerations

Permanent life insurance, like whole life insurance and universal life insurance, is generally a better choice than term life insurance. While term insurance is less expensive than permanent insurance — at least it is in the short run — it is subject to expiration or greatly increased premiums after a specified period of time. Permanent insurance, as its name indicates, can remain in effect for your entire life with premiums usually staying level for the duration of the insurance contract, or possibly ceasing in later years.

Policies You Own

Life insurance policies that you own are includible in your estate when you die. If you, were to transfer ownership of your life insurance policy to the special needs trust and also name the trust as the beneficiary of the insurance contract, you may receive two benefits:

- You may reduce the size of your estate by transferring ownership of the existing policy to the trust, because you will no longer own the policy; and
- Your family member with special needs, who would be the beneficiary of the trust but not of the policy, would never actually receive the death benefit directly; therefore, your family member would remain eligible for government benefits. Please note, as previously stated, when starting with an in-force life insurance policy on which you are the owner, you must outlive the transfer of ownership to the special needs trust by three years to remove the death benefit from your estate.

Anatomy of a Special Needs Trust

Result: You've enhanced the standard of living for the person with special needs by supplementing his or her government benefits and the family member will remain eligible for government benefits.

1

You consult with an estate planning attorney who has an understanding of special needs trusts.

2

You establish a special needs trust for the benefit of a person with special needs.

3

You designate a trustee capable of executing trust provisions.

4

You fund the trust with either liquid assets, such as cash or securities, or, with a life insurance policy.

The Choice of a Trustee

Family members can serve as trustees of the special needs trust, but only if they agree to assume this responsibility and are committed to making sure that the provisions of the trust are carried out to the fullest. Consider that planning for individuals with special needs is complex enough without possibly alienating other family members to whom you hope to leave a legacy. In addition, you should think carefully about who is best qualified to serve as your trustee. A corporate trustee may be a preferable alternative because of its ability to be both independent and objective in carrying out the provisions of the special needs trust without violating the state-specific Medicaid rules.

The Big Picture

Your special needs trust should be established as part of a financial plan that includes strategies that work in concert with each other to help provide all of your beneficiaries with the inheritance you desire. In creating your plan, you will need to work with a trust and estate attorney who specializes in setting up special needs trusts. The attorney will work to evaluate the state-specific Medicaid program and to establish your special needs trust in the context of a financial plan that meets all your objectives.

More Information

Detailed information on government benefits, including a brochure, titled "Benefits for Children with Disabilities" (SSA Publication No. 05-10026, January 2020, ICN 455360), is available from the Social Security Administration at 800-772-1213 or www.ssa.gov.

The Arc of the United States, www.thearc.org, represents people with intellectual and developmental disabilities. For information on a chapter in your area, call 800-433-5255.

The Special Needs Network (TSNN) is a not-for-profit corporation dedicated to helping families with dependents with special needs optimize the lifelong care of their loved ones. Access their website at www.tsnn.org.

Parenting Special Needs is an online magazine serving the special needs community. Access their website at http://parentingspecialneeds.org/.

.

WHAT IS AN ABLE ACCOUNT? ABLE Accounts, which are tax-advantaged savings accounts for eligible individuals with disabilities and their families, were created as a result of the passage of the Stephen Beck Jr., Achieving a Better Life Experience Act of 2014 or better known as the ABLE Act. The beneficiary of the account is the account owner, and generally income earned by the accounts will not be taxed. Contributions to the account made by any person (the account beneficiary, family and friends) will be made using post-taxed dollars and will not be tax deductible, although some states may allow for state income tax deductions for contribution made to an ABLE account.

AM I ELIGIBLE FOR AN ABLE ACCOUNT? The ABLE Act limits eligibility to individuals with significant disabilities with an age of onset of disability before turning 26 years of age. If you meet this age criteria and are also receiving benefits already under SSI and/or SSDI, you are likely eligible to establish an ABLE account.

Generally, the total annual contributions by all participating individuals, including family and friends, for a single tax year is generally $15,000 (for 2021) plus, in certain cases, the lesser of the amount of the beneficiary's compensation or the amount equal to the poverty line for a one-person household . The total limit over time that could be made to an ABLE account will be subject to the individual state and their limit for education-related 529 savings accounts. The first $100,000 in ABLE accounts would be exempted from the SSI $2,000 individual resource limit. If and when an ABLE account exceeds $100,000, the beneficiary's SSI cash benefit would be suspended until such time as the account falls back below $100,000. It is important to note that while the beneficiary's eligibility for the SSI cash benefit is suspended, this has no effect on their ability to receive or be eligible to receive medical assistance through Medicaid. The 2017 Tax Cuts and Jobs Act allows funds to be rolled over from a designated beneficiary's 529 plan to an ABLE account for the same designated beneficiary or a family member of the designated beneficiary (including the beneficiary's spouse). But this does not apply to the extent the amount distributed when added to other amounts contributed to the ABLE account exceeds the annual contribution limit ($15,000 for 2021).

WHICH EXPENSES ARE ALLOWED BY ABLE ACCOUNTS? A "qualified disability expense" means any expense related to the disability of the designated beneficiary and are for the benefit of that designated beneficiary in maintaining or improving his or her health, independence, or quality of life. These may include education, housing, transportation, employment training and support, assistive technology, personal support services, health care expenses, financial management and administrative services and other expenses. As of now ABLE accounts are not available through Morgan Stanley or any other broker/dealer. Currently an ABLE account can only be purchased directly though the state offering an ABLE plan.

CONCLUSION At the end of the day, individuals who qualify for governmental benefits may use a combination of a supplemental needs trust, an ABLE account, and perhaps also an account at a website such as helphopelive.org, which is a non-profit that provides the ability to create a fundraising page to cover the costs of uncovered medical expenses. As it is a non-profit, donations to your fundraising page are tax deductible, and the non-profit as well as your lawyer can help guide you as to how to use your funds without impacting governmental benefits.

Important Disclosure

Morgan Stanley Smith Barney LLC does not accept appointments nor will it act as a trustee but it will provide access to trust services through an appropriate third-party corporate trustee.

This material has been prepared for informational purposes only and is subject to change at any time without further notice. Information contained herein is based on data from multiple sources and Morgan Stanley Smith Barney LLC ("Morgan Stanley") makes no representation as to the accuracy or completeness of data from sources outside of Morgan Stanley. It does not provide individually tailored investment advice. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Be aware that the particular legal, accounting and tax restrictions, margin requirements, commissions and transaction costs applicable to any given client may affect the consequences described.

Tax laws are complex and subject to change. This information is based on current federal tax laws in effect at the time this was written. Morgan Stanley Smith Barney LLC, its affiliates, and Financial Advisors do not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning and other legal matters.