Morgan Stanley

WEALTH MANAGEMENT

# Planning for Individuals with Special Needs

## Estate Planning

**Wealth and Estate Planning Strategists**
Family Office Resources

Individuals planning for the financial well-being of a family member with special needs can face unique challenges, particularly when designing their financial and estate plan. Their financial and estate plan often needs to address the financial needs of their special needs family member without:

- Placing other family members in a position of responsibility over the finances of the individual with special needs, a responsibility that they may not be prepared for or willing to assume.

or

- Rendering the individual with special needs ineligible for government benefits like Supplemental Security Income (SSI) and Medicaid.

The chart below sets forth a comparison of some options available to families wrestling with these complex issues. While a number of options are available, setting up a trust for the benefit of the special needs family member can provide for such individual’s needs and preserve his or her eligibility for government benefits.

| CONTEMPLATED ACTION | POSITIVES | NEGATIVES |
|---|---|---|
| **Direct gift or bequest** | • Simplicity<br>• No cost to implement | • Individual may not be capable of managing assets<br>• May impact eligibility for government benefits<br>• Potential gift tax implications |
| **Direct gift or bequest to family member to provide for another individual with special needs** | • Simplicity<br>• No cost to implement<br>• Special needs individual remains eligible for government benefits | • Requires family member's commitment<br>• Assets may be at risk if family member faces litigation or divorce<br>• Potential gift tax implications for family member |
| **Special needs trust** | • Special needs individual remains eligible for government benefits<br>• Ability to direct the management of assets<br>• May reduce the chance of family conflict and turmoil<br>• Potential protection from creditors | • Requires services of an estate planning attorney<br>• Requires services of an independent trustee<br>• More expensive to implement |

## Safeguarding Benefits

Government benefits are available to help special needs individuals with food, shelter, health care and other living expenses. When 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 can provide for basic life necessities and enhance their lives.

With a special needs trust, a disabled individual can maintain eligibility for government benefits. In addition, the special needs trust can supplement those benefits with resources that will support a better standard of living.

## First Steps

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

There are different types of special needs trusts, including i) a first-party special needs trust, ii) a third-party special needs trust, iii) a first-party pooled special needs trust, and iv) a third-party pooled special needs trust. A first-party special needs trust is funded with property that the special needs trust beneficiary contributes. For example, a special needs individual may be entitled to funds from a financial settlement stemming from a litigated injury case. If the special needs trust beneficiary creates a first-party special needs trust, when the beneficiary passes away Medicaid has the right to make a claim against the balance of the special needs trust, for benefits provided to the beneficiary during his/her life. In contrast, a third-party special needs trust is funded with property owned by a third party, someone other than the special needs individual. Unlike a first-party special needs trust, Medicaid cannot make a claim on the balance of a third-party trust when the beneficiary passes away.

Another option to consider is to join an existing pooled special needs trust by signing a joinder agreement with a sponsoring non-profit organization, thereby establishing a separate sub-account for the beneficiary. Pooled special needs trusts are typically managed by 501(c)(3) organizations on behalf of a group, or pool, of individual beneficiaries with special needs. The benefit of these pooled special needs trusts is that multiple beneficiaries can share the costs of administering the special needs trust, and in turn allows each special needs trust beneficiary to participate and benefit from a special needs trust even if the beneficiary can only fund the trust with a modest amount of assets, typically fewer assets than an individual special needs trust. However, there are additional considerations with a pooled trust, as they can be less flexible regarding the timing of distributions, the trustee selection, and may have additional fees that are not generally found with individual special needs trusts. If the pooled special needs trust is funded by the beneficiary, it is considered a first-party pooled special needs trust, and the balance of the trust at the beneficiary's death is subject to Medicaid claims for reimbursement. But, if the pooled special needs trust is funded by anyone other than the beneficiary, it is considered a third-party pooled special needs trust, and is not subject to Medicaid's right of reimbursement.

Special needs trusts can be an important estate planning tool to consider for the family of an individual with special needs, and families should discuss with counsel to determine which type of special needs trust would be the most suitable for the special needs individual.

## How to Fund a Special Needs Trust

Special needs trusts can be funded with cash, securities, real estate or other assets. Most special needs trusts are funded with liquid assets such as cash and securities. For some grantors of third-party special needs trusts, especially those who would like their family members to have a higher standard of living, life insurance may be another option for funding the trust.

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, can be a better choice than term life insurance. While term insurance is less expensive than permanent insurance, it can be subject to expiration or increased premiums after a specified period of time. Permanent insurance, as its name indicates, can remain in effect for the insured's entire life with premiums usually staying level for the duration of the insurance contract, or possibly ceasing in later years.

## Ownership of Life Insurance Policies

Generally, life insurance policies are includible in the owner's estate when he/she dies. But, if the life insurance policy is owned by a special needs trust and the trust is also the beneficiary of the insurance policy, there are two potential benefits:

- The grantor may minimize estate tax exposure, because the insurance policy is not includible in the grantor's estate but is instead owned by the special needs trust; and
- The special needs individual preserves his/her eligibility for government benefits, because he/she is the beneficiary of the special needs trust, but not of the policy, and does not receive the death benefit directly.

## The Choice of a Trustee

When considering who to designate as trustee of a special needs trust, it is important to ensure the potential designee understands the complexity of the role and trust terms, agrees to assume the responsibility of serving as trustee, and is committed to making sure the provisions of the trust are carried out to the fullest. Family members can serve as trustees of the special needs trust. However, 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

A special needs trust can function as a key component of a financial and estate plan designed to provide supplemental benefits for a special needs beneficiary, while also earmarking the remaining balance of the trust as an inheritance for other beneficiaries. In creating an estate plan, it is important to work with an attorney who specializes in setting up special needs trusts. An estate planning attorney who is familiar with this area of law often will evaluate the state-specific Medicaid program rules and establish a special needs trust in the context of a financial plan that meets all the planning objectives.

## More Information

Detailed information on government benefits, including a brochure titled "Benefits for Children with Disabilities" (SSA Publication No. 05-10026, January 2026), 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.

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

**WHAT IS AN ABLE ACCOUNT?**

ABLE Accounts, are tax-advantaged savings accounts for eligible individuals with disabilities and their families, created as a result of the passage of the Stephen Beck Jr., Achieving a Better Life Experience Act of 2014, better known as the ABLE Act. The beneficiary of the account is also the account owner, and generally income earned in the account will not be subject is federal or state income tax as long as the funds are used for "qualified disability expenses." Contributions to the account can be made by any person (the account beneficiary, family and friends) are made using after-tax dollars. The contributions are not tax deductible to the donor for federal income tax purposes, but some states may allow for state income tax deductions for contributions made to an ABLE account.

**AM I ELIGIBLE FOR AN ABLE ACCOUNT?**

To be eligible for an ABLE account, an individual must have a qualifying disability. Effective January 1, 2026, the qualifying disability must have started before the individual reached age 46. Prior to 2026, eligibility was restricted to individuals whose disability began before age 26. In addition to the age requirement, the individual must also already be receiving benefits under Supplemental Security Income (SSI) and/or Social Security Disability Insurance (SSDI).

**HOW MUCH CAN I CONTRIBUTE?**

***Annual Contribution*** *Limits*

Generally, the aggregate annual contributions from all sources, including family and friends, for a single tax year is $20,000 (for 2026), sometimes referred to as the standard contribution limit. But, if the account beneficiary is employed, in addition to the standard contribution limit, the ABLE account is eligible to receive additional contribution up to the lesser of (i) the beneficiary's total compensation for the year or (ii) the poverty level for a one-person household in the previous year. As an example, in 2026, for an employed beneficiary with $18,000 of total compensation, his/her ABLE account could receive a standard contribution limit of $20,000, plus a maximum of $15,650.

***Lifetime Contribution Limits***

ABLE accounts also have a lifetime contribution limit, which is set by each state.

***SSI Threshold***

The first $100,000 in an ABLE account is exempt from the SSI individual resource limit ($2,000). But, if or when an ABLE account balance exceeds $100,000, the beneficiary's SSI cash payments would be suspended until the account drops 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 eligibility or ability to receive medical assistance through Medicaid.

***529 Rollovers***

Since the enactment of the 2017 Tax Cuts and Jobs Act, funds from a designated beneficiary's 529 plan can be rolled over to an ABLE account for the same beneficiary, or a family member of the designated beneficiary (including the beneficiary's spouse). But, 529 rollovers count toward the annual contribution limit, so an ABLE account may be ineligible to receive funds from a 529 rollover if the aggregate annual contributions from all other sources to the ABLE account has already exceeded the annual contribution limit ($20,000 for 2026).

**WHICH EXPENSES ARE ALLOWED BY ABLE ACCOUNTS?**

A "qualified disability expense" means any expense related to the disability of the designated beneficiary and is for the benefit of that designated beneficiary in maintaining or improving his or her health, independence, or quality of life.

These expenses 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. ABLE accounts are not available through Morgan Stanley, but they can be purchased directly through states that offer ABLE plans.

**CONCLUSION**

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, a non-profit that provides the ability to create a fundraising page to help defray the costs of uncovered medical expenses. As it is a non-profit, donations to the fundraising page are tax deductible for federal income tax purposes. When planning for individuals with special needs, it is important to obtain good counsel to help provide guidance on providing without negatively impacting government 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.

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CRC 5340883 04/2026