



Special Needs Trust Guide

I. What is a Special Needs Trust?

A special needs trust or supplemental needs trust (“SNT”) is a trust established for the specific purpose of providing support for a disabled individual. The goal of an SNT is to improve and enhance the disabled person’s quality of life while preserving any government benefits that the individual may be receiving. The most common federal government benefits received by disabled individuals are Supplemental Security Income (SSI) and Medicaid. To maintain eligibility for these programs, an individual’s assets may not exceed the sum of \$2,000. Funds held in a properly drafted SNT are not considered assets of the disabled individual. Accordingly, an SNT is a valuable instrument for providing goods and services that a disabled person would not otherwise be able to afford.

In general, there are two types of SNTs:

Self-Settled or First-Party Trusts

A self-settled or first-party SNT (commonly called a “special needs trust”) is one that is funded with the disabled person’s own assets. In most cases, a self-settled trust is established when a disabled person acquires a large sum of money, usually from an inheritance or a legal settlement from a personal injury lawsuit. It is a legal requirement of a self-settled special needs trust that any funds remaining in the trust at the time of the disabled person’s death must be used to reimburse the state for any Medicaid services provided on the person’s behalf. In addition, all distributions made from a self-settled trust must be made for the primary benefit of the disabled individual. If other persons can benefit from distributions made from a self-settled trust, the trust assets may be considered resources owned by the disabled person for SSI and Medicaid purposes resulting in a loss of benefits.

Third-Party Trusts

A third-party SNT (commonly called a “supplemental needs trust”) is one that is funded with the assets of someone other than the disabled individual. Third-party trusts are generally created by a parent or other relative who would like to provide financial assistance to a disabled person. Unlike a self-settled trust, assets remaining in a third-party trust at the time of a disabled person’s death do not have to be paid to the state and may be distributed to anyone designated by the creator of the trust.

II. Disbursements from Special Needs and Supplemental Needs Trusts

Although assets held in a special needs trust or supplemental needs trust are not counted as resources of a disabled individual for SSI or Medicaid purposes, disbursements from such trusts can nonetheless have a significant impact on the individual’s benefits. Certain distributions from a trust to a disabled person may be considered income. If a trust disbursement is considered income, it will reduce SSI benefits. Accordingly, it is necessary for the trustee of an SNT to have a basic knowledge of the rules of the SSI program.

SSI Income Rules

The most important rule for an SNT trustee to keep in mind is that the Social Security Administration will reduce an individual's SSI benefit by the amount income received in excess of \$20 on a dollar for dollar basis. Thus, if a disabled person is getting the maximum monthly SSI benefit (\$841 in 2022) and receives income of \$100 for the month, his or her SSI benefit will be reduced to \$761. Because the first \$20 of income received by the individual is disregarded, the receipt of \$100 reduces the SSI benefit by \$80. The receipt of income that is equal to or greater than the maximum SSI benefit, will result in the total loss of SSI. Because Medicaid benefits are often dependent upon the receipt of SSI, it is imperative that the disabled person limit their income to maintain SSI benefits. An SNT trustee must, therefore, avoid making distributions that will jeopardize the disabled person's SSI and Medicaid eligibility. Fortunately, by following a few simple guidelines a trustee can avoid making distributions that would be considered income for SSI purposes.

1. Do not Distribute Cash

The trustee should never distribute cash or anything that can be converted to cash to the disabled person. This includes gift cards, debit cards, or other items that can be redeemed for cash. Cash distributions to the disabled person are clearly income for SSI purposes.

2. Pay Vendors Directly

The trustee should directly pay vendors that provide goods or services to the disabled person. Most personal or household goods owned by a disabled person are not counted as part of the \$2,000 asset limit imposed by SSI and Medicaid. Disbursements from an SNT made to purchase these items are not considered income. Accordingly, the trustee may purchase the following goods or services for the benefit of the disabled person:

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| clothing; | internet service; |
| personal hygiene items; | books; |
| furniture; | musical instruments; |
| household furnishings; | subscriptions; |
| home modifications for handicap accessibility; | educational expenses and materials; |
| appliances; | entertainment; |
| telephone bills; | travel expenses; |
| cable bills; | health care services not provided by Medicaid; |
| computers; | medical devices |

Although an SNT trustee may pay vendors directly for the type of goods and services described above, the trustee may not reimburse the disabled person for any purchases he or she has made, even if such purchases are for exempt assets. Such a payment will be counted as a cash distribution from the trust and reduce the individual's SSI benefit on a dollar for dollar basis.

3. Do Not Purchase or Distribute Items Considered In-Kind Support and Maintenance

The trustee must avoid purchasing items for the benefit of the disabled person that are considered In-Kind Support and Maintenance (ISM). ISM is food, shelter, or anything that can be used to acquire food or shelter. The Social Security Administration lists the following items as ISM:

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| food; | gas; |
| mortgage payments; | electricity; |
| real property taxes; | water; |
| rent; | sewer; |
| heating fuel; | garbage removal |

When a distribution from an SNT is treated as ISM, the Social Security Administration will reduce the disabled person's monthly SSI benefit by an amount they refer to as the Presumed Maximum Value (PMV). The PMV is an amount equal to one-third of the maximum monthly SSI rate (\$841 in 2022) plus \$20. The PMV for 2022 is therefore \$300. The Social Security Administration will presume that any item of ISM received by a disabled individual in a month has a value of \$300 and will reduce the individual's SSI benefit for the month by that amount. For example, if the trustee of an SNT uses trust funds to purchase food for the disabled individual, such a distribution is considered ISM. The Social Security Administration will reduce the individual's SSI benefit by \$300 for the month. Although the disabled individual can attempt to rebut the Social Security Administration's presumption that the distributions had a value of \$300, it is generally not worth the effort to pursue such a challenge.

III. SSI Income v. Taxable Income

The rules defining income for SSI purposes described above should not be confused with income tax rules. Although distributions from an SNT for the benefit of a disabled person may not be considered income under the SSI regulations, such distributions are generally taxable to the disabled person for income tax purposes. For example, if the trustee of an SNT uses trust income to purchase \$5,000 worth of household furnishings for the disabled person, the trust distribution would not be considered income for SSI purposes. However, the disabled person would incur an income tax liability as a result of the distribution. Accordingly, a trustee should consider how a distribution from an SNT affects a disabled person's income tax obligations as well as their SSI and Medicaid eligibility.

IV. Trust Accounting and Income Tax

At the time an SNT is created, the trustee should apply for a Federal ID Number, often referred to as an Employer Identification Number (EIN). It is not necessary for a trust or other entity to have employees to obtain an EIN. It is simply the name given to the number used by the IRS to identify the trust for tax purposes. When the trustee opens an account at a bank or other financial institution, the EIN should be given to the bank as the tax ID number for the trust. The trustee should never use his or her own Social Security Number.

Trusts, like individuals, must pay taxes on their earnings. In any year that a trust has over \$600 of income, it must file a federal tax return (Form 1041). It may also be necessary to file a state income tax return. Who pays the tax is often dependent upon whether the trust is a first-party trust or a third-party trust. The disabled person/trust beneficiary is generally responsible for paying taxes on income earned by a first-party trust. For third-party trusts, however, the tax is paid at the trust level unless the income was actually distributed to the disabled beneficiary. The rules governing trust accounting are quite complex and a trustee should always work with an accountant who has experience preparing trust tax returns.

IV. Living Arrangements

It is quite common for an SSI recipient to live with his parents or another relative. When a disabled person resides in another's home and receives food and shelter without paying rent, the Social Security Administration will reduce the person's benefit by an amount equal to one-third of the maximum SSI benefit. This is known as the "value of one-third" or "VTR" reduction. For 2022, the VTR is \$280 ($\$841 \div 3$). In order to avoid this reduction, the disabled person must reimburse the homeowner for his pro-rata share of food and housing expenses.

V. STABLE Accounts

A STABLE Account is the named used in the state of Ohio for accounts established under the federal Achieving a Better Life Experience Act of 2014 (the ABLE Act). The ABLE Act authorized the establishment of accounts for disabled individuals that are not countable assets for Medicaid or SSI purposes. In order to qualify for a STABLE Account, an individual must have been disabled prior to achieving the age of 26. The disabled individual or any other person may contribute funds to the individual's STABLE account. The maximum amount

that may be deposited to the account in each calendar year is limited to \$16,000. This amount is consistent with the federal annual gift tax exclusion and will be adjusted for inflation. Contributions to a STABLE Account are not considered income of the disabled individual. Moreover, a disabled person will remain eligible for SSI benefits so long as the balance of their STABLE Account does not exceed \$100,000. At the disabled individual's death, however, any funds remaining in the STABLE Account must be used to reimburse the state for Medicaid benefits paid on the individual's behalf.

Earnings on the funds held in a STABLE account accumulate on a tax free basis, and withdrawals by the disabled individual are tax free if made for "Qualified Disability Expenses." According to the Social Security Administration, Qualified Disability Expenses include, but are not limited to:

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| education; | financial management and administrative services; |
| housing; | legal fees; |
| transportation; | expenses for STABLE Account oversight and management; |
| employment training and support; | funeral and burial expenses |
| assistive technology and related services; | |
| health; | |
| prevention and wellness; | |

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