

OAST & HOOK

Offices in  
Portsmouth and  
Virginia Beach, Virginia  
Tel: 757-399-7506  
Fax: 757-397-1267  
Web: www.oasthook.com



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### INSIDE THIS ISSUE

- Planning for IRA Beneficiaries with Disabilities
- Oast & Hook
- Disbribution of this Newsletter

Editor  
Sandra L. Smith,  
Certified Elder Law  
Attorney

## PLANNING FOR IRA BENEFICIARIES WITH DISABILITIES BY EDWARD WILCENSKI

An owner of an individual retirement account (IRA) and the IRA owner's advisors need to be aware of the importance of careful planning when an IRA beneficiary has a disability. In many cases, astute estate planning calls for the beneficiary of an IRA to be a trust. If an intended beneficiary has a cognitive disability and is not capable of managing his or her own money, then this beneficiary may also be supported in the community through a variety of means-tested entitlement programs, such as Supplemental Security Income (SSI) and Medicaid. In most of these means-tested programs, the beneficiary's receipt of funds from an IRA will terminate the beneficiary's participation in the program. In such a case, the planner should consider whether a special needs trust should be part of the client's overall estate plan. These trusts are designed to allow the beneficiary to maintain eligibility for most means-tested programs, while still allowing the trustee to access trust funds to pay for goods and services that enhance the quality of the beneficiary's life.

A third-party special needs trust is funded with the assets of another party, such as the beneficiary's parents. This might be either a trust created under a will (a testamentary trust) or a "freestanding" trust drafted specifically for this purpose. The special needs trust would be named as the beneficiary of the IRA. Upon the beneficiary's death (and presuming there were funds left in the trust), the remaining balance could be distributed to other family members.

If a client wants to name a special needs trust as the beneficiary of an IRA, then the planner should be familiar with two more terms: "conduit trusts" and "accumulation trusts." As a rule, a special needs trust should not be drafted as a conduit trust. That is, it should not be a single-beneficiary trust where the trustee is required to take at least the required minimum distribution (RMD) from an IRA each year and then pass that amount directly to the beneficiary. In general, trust assets paid out directly to the beneficiary will disqualify the beneficiary from participation in most means-tested programs. Instead, a

special needs trust will usually allow the trustee to accumulate income (including the minimum distributions taken by the trustee) within the trust, so it will be an accumulation trust.

Although using an accumulation trust will prevent the loss of entitlement program eligibility, RMDs must be taken over the life expectancy of the oldest trust beneficiary. Ideally, the beneficiary with a disability will be named as primary beneficiary, and someone close to the beneficiary's age or younger will be the contingent or remainder beneficiary. For example, a sibling or cousin might be named. If such a backup beneficiary exists and can be included in a manner consistent with the client's estate plan, then RMDs can be stretched out and valuable tax deferral preserved.

That ideal outcome is not always possible, and it may be inconsistent with the client's overall planning objectives. For example, a beneficiary with a disability may be receiving services and support from a charitable organization that serves the community of those with special needs. In many cases, the beneficiary's parents want to ensure that the funds in the trust will be available for the lifetime of the child, with the remainder passing to the charity in recognition of its hard work and advocacy. Because the charity is not considered a "designated beneficiary" for RMD purposes, the IRA would have to be distributed much more rapidly (fully distributed by the fifth anniversary of the IRA owner's death, if death occurs before the IRA owner's required beginning date). If the IRA owner dies after the IRA owner's required beginning date, then the payout will be over the deceased IRA owner's remaining single life expectancy. Neither of these options is generally as good as stretching distributions over the beneficiary's longer lifetime. This dilemma is frequently encountered in situations where the person with the disability is an only child.

One solution is to have the parent leave the IRA to a charitable remainder trust (CRT). The IRA can be fully distributed to the CRT without adverse tax consequences. A separately drafted special needs trust can be designated as the income beneficiary of the CRT. Depending on how the special needs trust is designed, the CRT may pay income to the special needs trust for 20 years or for the life of the beneficiary with a disability. Payments from the CRT can be accumulated within the special needs trust or used for the beneficiary, as described above. Upon the death of the beneficiary (and subject to some restrictions suggested by IRS Revenue Rulings and Private Letter Rulings on this subject), funds left in the CRT will pass to the charity. Any funds remaining in the special needs trust would pass to an individual or entity selected by the parents. While this can be a cumbersome arrangement to establish and administer, it can be a highly effective way to maximize the dual objectives of the families of individuals with disabilities.

Incorporating gifts to charities into an estate plan that also includes a special needs trust presents a challenge for the planner and the client alike. Good legal advice from an attorney well-versed in both charitable estate planning and special needs planning is a must.

Advisor action plan:

- Find out if a client wants to leave some or all of an IRA to a beneficiary with a disability.

- If that is the case, then determine whether that individual with the disability is incapable of handling finances and is reliant on means-tested government programs.
- If these situations apply, then suggest to the parents that they leave the IRA to a special needs trust. This should be an accumulation trust in which the trustee has complete discretion over distributions.
- See if there is another individual, about the same age as or younger than the special needs trust beneficiary, who can serve as backup beneficiary of the trust.
- If the IRA owner wants any remaining trust assets to go to a charity, then suggest using a charitable remainder trust as the IRA beneficiary and naming the special needs trust as the income beneficiary of the remainder trust.
- Work with an attorney experienced in drafting special needs trusts. The Special Needs Alliance ([www.specialneedsalliance.com](http://www.specialneedsalliance.com)) is a national organization of attorneys with this background and expertise.

Oast & Hook is the southeast Virginia member of the Special Needs Alliance. The attorneys at Oast & Hook can help clients who have family members with disabilities properly plan for them.

*Edward L. Wilcenski is the president of the Special Needs Alliance. He practices with the law firm of Jones and Wilcenski PLLC in Clifton Park, New York.*

### **Oast & Hook**

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