

Special Needs Trusts and Life Insurance Beneficiary Designations

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As noted in a prior article, we encourage readers to submit questions so that we may provide you with guidance on issues both of concern and interest. Below is a question recently posed by a client who is an individual with disabilities who may benefit from a future inheritance, and our related response:

"If your parents name you as the beneficiary of their life insurance [and you are an individual with disabilities who receives public benefits] can the insurance proceeds be put into a special needs trust?" If a parent has a child with disabilities who likely will need the assistance of public benefits during the course of his or her lifetime, the best approach is **not** to list the child directly as the beneficiary of life insurance policies (or an IRA, 401k, etc.). Rather, a parent should consider naming the trustee of a previously-created special needs trust as the beneficiary of the child's share of an inheritance. This type of special needs trust, established by and with the funds of a parent (or any other relative) for the benefit of a child with disabilities is known as a "third-party" special needs trust. Because the trust assets never belonged to the child who is named as the trust beneficiary, the parent who establishes the third-party trust has the right to dictate how any funds remaining upon the child's death will be distributed.

If a parent fails to do this type of special needs planning and, instead, names the child directly as the beneficiary of life insurance or retirement benefits, the child with disabilities will receive the funds directly. In most cases, receiving the cash benefits in hand will render the child ineligible for public benefits programs that have income and resource limits, like Supplemental Security Income (SSI) and Medicaid. All will not be not lost, however, since the child still may put the funds into his or her own special needs trust in order to reestablish financial eligibility for public benefits. However, the type of trust the child must use for his or her own funds -- known as a "self-settled" trust -- does *not* permit the child (or parent or other relative from whom the monies originated) to control what happens with funds remaining in the trust at the child's death. There are two common types of self-settled trusts (the details of which will be covered in other

articles), both of which require the remaining trust funds first be used to reimburse the state(s) for any Medicaid benefits paid on the child's behalf over the child's lifetime. Consequently, establishing a third-party special needs trust for a child in advance gives the family much greater control over how funds ultimately will be distributed.



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At Butenhof & Bomster, PC, we focus our practice in the areas of elder law, estate planning, Medicaid planning, special needs trusts planning, guardianships, and probate and trust administration. Simply put, our philosophy is that each client's circumstances are unique and deserving of individualized attention and planning, regardless of whether such planning involves the creation of a complex trust structure or simply the execution of a health care power of attorney.