

USING THIRD PARTY SNTs IN ESTATE PLANNING

An Excerpt from the
presentation for
Stetson University College of Law
2010 Special Needs Trusts - The National Conference

by
Stuart D. Zimring

Date
October 22, 2010

Law Offices Of

STUART D. ZIMRING

Attorneys & Counselors At Law

USING THIRD PARTY SNTs IN ESTATE PLANNING

Stuart D. Zimring

1. Third Party SNTs

Third Party SNTs are those created for the benefit of a person with a disability that makes that person an appropriate beneficiary of a SNT and are funded with assets belonging to someone other than the SNT's beneficiary. The easiest example of a Third Party SNT is where parents of a child with a disability create, as part of their own estate plan, a SNT for the benefit of their child and provide in their estate planning documents that the child's share of the inheritance is distributed to the SNT rather than to the child directly.

2. SNTs and The Estate Plan

A. Testamentary SNTs for the Surviving Spouse

1. For reasons that, to a certain extent, defy logic and definitely go beyond the scope of this paper, one spouse can transfer assets to a SNT created by her Will (*i.e.* a testamentary trust) for the benefit of the surviving spouse without the transfer being considered a disqualifying transfer for public benefit purposes, or the corpus of the testamentary trust being considered an available resource of the surviving spouse.

2. In a "conventional" estate plan, utilizing a revocable inter-vivos trust, the couple would ordinarily divide the assets on the first death into a "survivor's trust" and a "decedent's trust" or "exemption trust" (if there is an estate tax exemption available). If the surviving spouse is the beneficiary of the decedent's trust and that trust is structured as a support trust (*i.e.* the Trustee is authorized and directed to make distributions of principal and income for the "health, education, maintenance

and support” for the surviving spouse), the decedent’s trust would be considered an available resource of the surviving spouse for Medicaid purposes.

3. If however the trust provides that on the death of the first spouse to die his assets are transferred to the trustee of a testamentary special needs trust created by his Will for the benefit of his surviving spouse, the assets will not be countable assets for Medicaid purposes and will be shielded from estate recovery. This is because the statute specifically includes as available resources assets transferred from one spouse to the other in a trust created “other than by Will.”¹ The testamentary trust is a trust created by Will and therefore falls outside the statute.

4. If the revocable inter-vivos trust provides that the distribution is to the trustee of the testamentary trust rather than to the estate of the deceased spouse, the assets will not be subject to probate, which in some jurisdictions such as California can result in a significant savings in probate expenses.

5. As a result, the first spouse to die can leave his property in a SNT for the benefit of the surviving spouse regardless of age.²

B. Stand-Alone SNTs with *Crummey* Provisions

¹42 U.S.C. §1396p(d)(2)A)

²42 U.S.C. §1396p(d)(2)A), See for example 22 Cal. Code Regs. §50489.5(a)(1).

1. A Third Party SNT can contain *Crummey* powers so that the contributions to the SNT will qualify for the annual gift tax exclusion. The only difference between the use of *Crummey* Powers in the context of a SNT and an irrevocable life insurance trust (for example) is that the beneficiary of the SNT cannot be one of the holders of a *Crummey* Power since this would give her an immediate interest in the gift which could adversely affect her public benefit entitlements. Thus, under the rationale of *Estate of Maria Cristofani*³ The *Crummey* Power holders should be the remainder beneficiaries of the SNT rather than primary beneficiary.

C. Using Life Insurance and Retirement Benefits to Fund the SNT

1. Most parents, if asked how they would want their estate divided at death, would respond “equally among all my children.” While this is a natural, loving response, it ignores the reality that a child with special needs will require a disproportionate amount of assets to maintain herself and probably will not have the wherewithal to generate such an amount on her own. In such cases making the SNT the beneficiary of life insurance provides an incredibly valuable tool in solving this conundrum.

2. Thus, the traditional irrevocable life insurance trust, long used as a vehicle to shelter the proceeds of life insurance policies can be drafted as a Third Party SNT.

³97 T.C. 74 (1991) *acq.*, 1992-1 Cum. Bull. 1, *acq.*, 1996-2 Cum Bull. 1. See also, Zimring, Morgan, Frigon *Fundamentals of Special Needs Trusts* §3.03[a] (Matthew Bender).

3. Similarly, in situations where a disproportionate amount of the parents' wealth is in the form of a retirement plan or plans such as IRAs, Roth IRAs, 401(k) or 403(b) plans, the Third Party SNT can be designated as a "designated beneficiary" if the SNT is structured properly.⁴

D. Distributions From A Charitable Remainder Trust to a SNT

1. Clifton Kruse, in his treatise, *Third-Party and Self-Created Trusts* (3d ed.), analyzes IRS Revenue Ruling 76-270, 1976 C.B.-2 194 which inferred that a Charitable Remainder Trust (CRT) could make its distributions to a trust for the benefit of a disabled child.⁵ In essence, this technique permits a charitably inclined individual to realize an immediate income tax deduction, receive income back and/or have the income stream paid to the trustee of a SNT. There are thus two instruments involved: the charitable gift annuity or CRT on the one hand, and the SNT (the receptacle trust) on the other.

In 2002, the IRS released Revenue Ruling 2002-20 which, by its terms, amplifies and supersedes Revenue Ruling 76-270. This new ruling explicitly validates the use of SNTs as receptacle trusts for distributions to a SNT. The facts of the Ruling stated:

"An individual concurrently creates Trust A, a trust that otherwise qualifies as a charitable remainder unitrust, and a separate trust, Trust B. Under the governing instrument of Trust A, annual unitrust amounts will be paid to Trust B for

⁴I.R.C. §401(a)(9). For a detailed discussion of the use of life insurance in SNTs and the application of the "designated beneficiary" rules to Third Party SNTs see Zimring, Morgan, Frigon *Fundamentals of Special Needs Trusts* §3.03[6], [7] (Matthew Bender).

⁵Clifton Kruse, *Third-Party and Self-Created Trusts* (3d Ed.) Page 195, ABA 2002.

the life of *C*. *C* is an individual who is financially disabled, that is, *C* is unable to manage *C*'s own financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.”

Situation 3 of the FACTS section of the Ruling states:

Situation 3. Under the governing instrument of Trust *B*, the Trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of *C*. Upon *C*'s death, the governing instrument requires the trustee to reimburse the state for the total costs of medical assistance provided to *C* under the state's Medicaid plan. *C* is given a testamentary general power of appointment over the balance remaining in Trust *B*. If *C* fails to exercise the power, the balance will be distributed in equal shares, to *C*'s sister and to *X*, a charitable organization.”

In its analysis, the Service states:

“In these situations, the use of the assets in Trust *B* during *C*'s life and at *C*'s death is consistent with the manner in which *C*'s own assets would be used. *C*, therefore, is considered to have received the unitrust amounts directly from Trust *A* for purposes of §664(d)(2)(A). Accordingly, the term of Trust *A* may be for the life of *C* and is not limited to a term of years.”⁶

Thus, If a charitable remainder trust is the primary vehicle,

the payout language might read:

“In each taxable year of the Trust, the Trustee shall pay to [Disabled Person's] Special Needs Trust created to comply with Rev. Rul. 2002-20 as a permissible individual hereinafter referred to as ‘the Recipient’ during the Recipient's lifetime...”

⁶Rev. Rule 2002-20

Corresponding language in the SNT itself would read:

“Trust Estate:

The trust will be the receptacle for payment of a stream of payments from a Charitable Remainder Trust as described in Exhibit A, payable to the Trustee for the benefit of the beneficiary. Such stream of payments, together with any income and other accruals on the corpus, shall constitute the Trust Estate.”