Planning for a Family Member with Special Needs: Part IV

<u>Funding Sources for a Special Needs Trust</u>

Family members often experience a sense of accomplishment when they sign their special needs trusts (SNTs), but signing trust documents is really only the first step in reaching the ultimate goal. The SNT is just a piece of paper if the clients and their team of advisors (often a lawyer, financial adviser and accountant) have not planned how to fund the trust.

Question: How should a family fund the costs of a beneficiary's needs as indicated in a life care plan?

Answer: Most families will use a combination of "probate" assets (i.e., those assets that pass under a will or living trust) and "non-probate" assets (i.e., those assets that pass outside of a will pursuant to a beneficiary designation—e.g., an IRA or 401(k) account). Virtually every single family that aims to secure the future of a person with a disability uses life insurance as part of the funding mechanism.

Question: What are the benefits of using life insurance to fund an SNT?

Answer: Part of special needs planning involves caring for a loved one after you are gone. The problem is, knowing when you will pass away is impossible and thus having a plan for how to fund that scenario is nearly impossible. By funding an SNT with life insurance, you can help ensure that your planning has the funding it needs to carry on after your death.

Question: What type of life insurance should a family acquire to help fund the life care plan of a person with a disability?

Answer: If the disability is permanent and will be a lifelong challenge, then term life insurance will not fully meet the funding need. Most families that are funding a loved one's life care plan with insurance will need a "permanent" type of life insurance that will not expire (or become prohibitively expensive) at the end of a relatively short period of time. Permanent life insurance products include whole life, universal life and variations of those.

Question: What is the most cost-effective type of life insurance policy to consider?

Answer: Many families find that a second-to-die life insurance policy is the most realistic option to fund an SNT because the premiums are often lower and the trust is funded when it is most needed: after both parents have passed away. In short, how much you fund your SNT and how large an insurance policy to purchase will be a question of balance among your current needs, your retirement funding, the needs of your other children, if any, and the anticipated needs of your child with special needs.

Question: After the type of insurance policy is chosen, who should the policy name as the trustee of the special needs trust?

Answer: Whatever type of insurance policy is chosen, the policy must name the trustee of the SNT, in his or her capacity as trustee, as beneficiary of the policy, rather than naming either the trust itself or the individual with special needs. Ideally, the trust will own the policy as well, and this can be done by having the owner of the policy transfer the policy to the trust, or by having the trust apply as owner of the coverage in the first place.

Question: What is an irrevocable life insurance trust? Who should consider it for special needs planning?

Answer: Traditionally used as an estate planning tool, an irrevocable life insurance trust (ILIT) is an advantageous structure because the assets in the trust are outside of a person's taxable estate. By funding a life insurance policy during your life, you are able to essentially prepay a death benefit that is outside of your estate. If your child inherits assets outright, their eligibility for government benefits can be affected. If your legacy is a life insurance death benefit inside of an ILIT, it will never pass through your estate and affect benefit eligibility, but it can still be there to help your family.

In summary, be sure to create or update an estate plan and determine which of your assets you'll leave to the SNT. Also, don't forget to advise relatives of the importance of directing gifts and bequests directly to the SNT, rather than the child, to avoid the risk of disqualifying the child from eligibility for public benefits.

Please feel free to reach out to Page Harty at SignatureFD for further information or questions regarding the need for insurance to fund your special needs planning.

SIGNATUREFD

Page Harty, CFP®, CDFA, Partner
1230 Peachtree Street, NE
Suite 1800
Atlanta, GA 30309
T 404.253.7656
F 404.253.7657
M 404.323.8277
MAIN T 404.253.7600
MAIN F 404.253.7601

Page.Harty@signaturefd.com
www.signaturefd.com