What is a "Third-Party" Special Needs Trust and How is it Different From Other Kinds of Trusts?

Special needs trusts come in three main flavors -- first-party special needs trusts, third-party special needs trusts, and pooled trusts. All three trust varieties are designed to manage resources for a person with special needs so that the beneficiary can still qualify for public benefits like Supplemental Security Income (SSI) and Medicaid. While first-party special needs trusts and pooled trusts hold funds that belong to the person with special needs, third-party special needs trusts, as the name implies, are funded with assets that never belonged to the trust beneficiary, and they provide several advantages over the other two types of trusts.

Third-party special needs trusts are set up by a donor – the person who contributes the funds to the trust. These trusts are typically designed as part of the donor's estate plan to receive gifts that can help a family member with special needs while the donor is still living and to manage an inheritance for the person with special needs when the donor dies. Third-party special needs trusts can be the beneficiaries of life insurance policies, can own real estate or investments and can even receive benefits from retirement accounts (although this process is very complicated and not typically recommended unless there aren't other assets available to fund the beneficiary's inheritance). There is no limit to the size of the trust fund and the funds can be used for almost anything a beneficiary needs to supplement her government benefits. Upon the beneficiary's death, the assets in a third-party special needs trust can pass to the donor's other relatives or anywhere else.

This last factor is one of the key advantages of a third-party special needs trust: because the funds in the trust never belonged to the beneficiary, the government is not entitled to reimbursement for Medicaid payments made on behalf of the beneficiary upon her death, unlike with a first-party or pooled trust. This allows a careful donor to benefit her family member with special needs while potentially saving funds for other people who don't have the same needs.

Whereas first-party trusts must be established for the benefit of someone who is younger than 65, third-party trusts don't have age limits. In some states, first-party trusts must be monitored by a court, but third-party trusts almost never have to go through this same process, especially while the donor is still alive. In addition, while the donor is living, funds in the trust usually generate income tax for the donor, not for the beneficiary, avoiding the complication of having to file income tax returns for an otherwise non-taxable beneficiary and then explain them to the Social Security Administration.

Although a third-party special needs trust has many advantages, it is not always a viable option for families of people with special needs. One of the major drawbacks of a third-party trust is its absolute inability to hold funds belonging to the person with special needs. So if the trust beneficiary receives an inheritance that wasn't directed into the special needs trust to begin with or if she settles a personal injury case, the funds have to be placed in either a first-party trust or a pooled trust, since even one dollar of a beneficiary's own money could taint an entire third-party trust. But even with these restrictions, most people trying to help a family member with special needs are going to at least need to strongly consider drafting a third-party special needs trust. Attorney D'Onofrio can help you understand how these important trusts fit into your other estate planning goals.

For more information about special needs planning in general and special needs trusts in particular, contact Attorney John D'Onofrio today.

As a member of the Academy of Special Needs Planning, John is constantly reviewing new laws and amendments in this area of law as well as attending seminars and continuing education classes relevant to special needs planning and trusts.

Call today to schedule a free initial consultation. Call today, get peace of mind today.

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