Special Needs Alliance
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The Voice, *The Official Newsletter of SNA*

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Welcome!

You are reading *The Voice*, a newsletter published by The Special Needs Alliance. Our purpose is to provide information--and answers--about special needs planning for family members and professionals. We hope this newsletter helps you. We would love to hear your questions, suggestions and comments; please feel free to e-mail us. We also encourage you to forward our newsletter to others who might benefit from the information here, or who might have similar questions.

Special Needs Trusts and Individual Retirement Accounts

Questions from a reader: "I have established a special needs trust for my 50-year-old daughter. I want to leave my IRA to the trust. Is that possible?

Also, my daughter lives in one state and the trust was established in another. Are there any restrictions or differences I need to know about between states? Where will the trust principal be held, and can trust money be spent on anything beyond the benefits she receives?

Our response: First, let's talk about the differences between states. Your special needs trust can use money it holds (including anything it receives from your IRA) to supplement your daughter's care. In other words, the trust money is used to pay for items that government benefits do not pay for.

As you might guess, there are restrictions. Each government benefit program and each state has separate rules, though there are common elements across programs and states. You should talk to an attorney where your daughter resides to make sure that there are not issues peculiar to that state. You can find an attorney experienced in dealing with special needs trusts in just about every state by looking at the Special Needs Alliance website.

Although there are differences by state, the rules tend to be

quite similar. In addition, if your daughter qualifies for federal benefits (such as Supplemental Security Income, or SSI, payments), that might mean she automatically qualifies for state-run benefits (like Medicaid) regardless of the state's individual restrictions.

Now for the tax question: Yes, you can leave your IRA to the special needs trust for your daughter. You should know, however, that naming the trust as beneficiary may impact how fast the IRA must be paid out after your death. The complicated rules are usually described as the "minimum distribution" rules.

As you probably know, you are required to take minimum distributions from your IRA each year after you reach age 70 1/2. The minimum distribution rules also apply to the IRA you leave to your daughter's special needs trust.

Your special needs trust can be constructed to allow the minimum distribution rules to be recalculated using your daughter's life expectancy after your death. If you are not cautious, however, the trust language might force the IRA distributions to be completed in a much shorter time period--perhaps even within five years of your death.

The minimum distribution rules, as the name implies, only describe the *minimum* speed with which the IRA holdings must be distributed. More can be taken out than is required, but every distribution is subject to income tax. In other words, more withdrawals from the IRA mean more taxable income.

As is so often the case when dealing with special needs trusts, the rules are complicated--and many competent tax practitioners are unfamiliar with the wrinkles introduced by special needs issues. You should consider contacting a Special Needs Alliance member in either your state (for convenience and to explore the tax issues) or your daughter's state (to discuss the treatment of special needs trusts where she lives--that attorney can also talk to you about the tax issues).

Where the trust will be located. You also asked where trust principal will be held. Many trust beneficiaries--and not a few lawyers and other professionals--are surprised to learn that the trust actually is controlled by the legal system in the state where the trustee lives. If you live, for example, in Illinois, and your daughter in Texas, but your son (who lives in Colorado) is named as trustee after your

death, the trust will become a Colorado trust when your son takes over. The trust itself may include language that, for example, Illinois law will apply--but the "situs" of the trust will still be where the trustee lives and the majority of trust administration takes place.

After your death, your successor trustee should have no difficulty managing the IRA and any other trust assets from his or her home. It is unlikely that any legal proceedings will be required to interpret, protect or enforce your trust, but if there are they should take place in the trustee's home state.

About the Author: Bradley J. Frigon is a Colorado lawyer and a member of the Special Needs Alliance. His practice is in Englewood, a suburb of Denver. Brad has published and spoken extensively about taxation issues and about the interplay of worker's compensation claims and Medicare benefits, and the use of "Medicare Set-Aside Arrangements" in such cases. He is admitted to practice in Colorado and Kansas, and he is currently a member of the Board of Directors of the National Academy of Elder Law Attorneys.

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