Special Needs Planning in Alabama: A Deep Dive into Important Concepts

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WHAT IS SPECIAL NEEDS PLANNING?

Special needs planning is a distinct area of law that focuses on optimizing the quality of life for someone, often a spouse, child, or grandchild, who has health conditions or impairments. Special needs planning is often considered a sub-specialty of estate planning, but is likely more accurately a subspecialty or a part of elder law, since both the National Academy of Elder Law Attorneys and the National Elder Law Foundation have strong and robust special needs law divisions.

Over the past decade, special needs law has progressed and changed perhaps more than any other area of law in America. Before the disability rights movement took hold, individuals with special needs were often disinherited altogether in estate plans and readily stripped of their freedom and autonomy through court proceedings without much thought. Additionally, before just a few years ago, guardians, courts, and attorneys were presumed to always know what was best for individuals with special needs. Thankfully, the law has moved beyond this downward-looking, paternalistic framework and moved toward what is known as "person-centered planning."

Person-centered planning seeks to empower an individual with special needs to make and communicate decisions about their own well-being while also providing them assistance in areas in which they are unable to manage their affairs. Instead of beginning the analysis by asking what the person cannot do, person-centered planning begins by asking what the person *can* do, while also considering the person's weak areas in which they might need assistance. Accordingly, a special needs law attorney might begin a consultation with a family who has a loved one with special needs by asking the individual with special needs or the family member present at the meeting to tell the attorney about the person with special needs, such as their strengths, weaknesses, character, and hobbies.

One of the most exciting aspects of person-centered planning is its opportunities to customize a specific plan particularly tailored to meet each individual's needs. For example, an individual might be able to obtain employment, but may be unable to remember to balance their checkbook or pay taxes. Perhaps an individual can handle routine financial transactions like paying for groceries, but needs checks and balances of sorts for more major transactions and detecting potential fraud. Or consider the example of a beneficiary with more severe limitations, who might be incapable of handling their own financial affairs, but is more than capable of determining where they want to live or which doctor they want to see. The ability to customize plans based on each individual's strengths, weaknesses, capacity, needs, and desires, is the heart of person-centered planning.

Another major component of special needs planning is maximizing government benefits for the individual. This often involves structuring one's assets and estate plan so as to preserve any means-tested government benefits that might be lost if the individual with special needs were to receive an inheritance from family members or friends. Specific examples of these types of benefits and strategies to preserve them are discussed later in this guide. Special needs planning can involve a number of objectives and considerations, including:

Allowing appropriate personal autonomy
Maximizing government benefits
Health insurance planning
Job, social, and communal planning
Minimizing taxes
Planning for adulthood
Planning for improvement or deterioration
Planning for death
Coordination with your overall estate plan

GOVERNMENT BENEFITS

Obtaining, maximizing, and preserving an individual's eligibility for government benefits is one of the most important aspects of special needs planning. Unfortunately, federal and state law on these matters is far from straightforward. In particular, Medicaid is largely considered by attorneys and other advocates as one of the most convoluted and difficult areas of law. Additionally, the sheer breadth of benefits (and the laws that regulate them) presents its own unique problem: oftentimes, a meeting with a special needs attorney is the first time many parents hear or understand that their child might be eligible for cash benefits as soon as they obtain the age of 18 (and sometimes sooner).

Who is "disabled"? and Who decides?

As many families who have a family member with special needs know, there is no real definition of when a person has or does not have "special needs." Additionally, having special needs is not synonymous with being "disabled." Nonetheless, in order for anyone to avail themselves of many of the benefits discussed in this guide, a person must meet the Social Security Administration's definition of "disabled". The SSA defines a person as "disabled" if they are unable to do "any substantial gainful activity" due to a physical or mental impairment which has lasted or is expected to last for a continuous period of at least 12 months, or is expected to result in death. The SSA has a different, more nebulous definition of "disabled" for applicants who are children. A child is considered "disabled" by the SSA if they have an impairment resulting in "marked and severe functional limitations." The SSA allows for appeals if an applicant is rejected for disability status. While obtaining a disability ruling from the SSA can allow a person to obtain many government benefits that they otherwise could not receive, special needs planning can positively impact many families, whether or not one or more of their family members has been declared "disabled" by the SSA.

Health insurance

Most Americans are now aware that a child may remain insured under their parent's private health insurance plan until they are 26 years old. Upon attaining age 26, a person with special needs must usually obtain health insurance through other means, such as through a private health insurance plan, Medicaid, or, in very rare instances, Medicare. Obtaining private insurance can be difficult for an individual if they are unable to obtain full-time employment, which generally carries health insurance coverage. If a person is unable to enroll in an employer's health insurance program, they might look to a health insurance exchange market created under the Patient Protection & Affordable Care Act. But it can also be difficult to obtain health insurance through an exchange because, even though federal law provides subsidies to help pay for some or all of the plan's premiums, an unintended but very much valid federal law requires that a person must not have a household income below the poverty line in order to receive a premium subsidy for private health insurance.

In states that have not expanded Medicaid coverage under the Patient Protection & Affordable Care Act, such as Alabama, this results in a "coverage gap" for people too poor under this unintended rule to obtain a subsidy but fail to meet the categorical guidelines for Medicaid eligibility (discussed later in this guide). This can be remedied if the beneficiary is declared "disabled" by the SSA, which is why the disability determination is often so crucial in special needs planning.

Social Security Income and the Doors it Opens

Social Security Income ("SSI") is a tax-free cash benefit given to individuals who are blind, disabled, or at least 65 years old. It is designed to cover housing and food costs for people who cannot afford these two life necessities, although in many parts of the country, even the maximum SSI benefits are not enough to cover housing costs. As of 2024, the maximum SSI benefit is $943 per month for an individual.

If a person earns income, that income will reduce the amount of SSI that the person receives. By how much income reduces a person's SSI benefit depends on whether the income is "earned" or "unearned." Unearned income includes income from interest and dividends as well as cash from family and friends. Earned income refers to income earned from employment. Unearned income reduces a person's SSI benefit "dollar for dollar", while earned income reduces a person's benefit by 50 cents for every dollar of earned income that a person earns.

SSI is significant in that if a person is eligible for SSI, they are categorically eligible for Medicaid. This means that so long as a person is eligible for and is receiving at least one dollar per month of SSI, they are automatically entitled to Medicaid. Obtaining eligibility for SSI is even more significant in states like Alabama which have not expended Medicaid because it is simply one of the few ways that an individual can qualify for Medicaid. In the over 40 states that have expanded Medicaid, obtaining SSI is not nearly as pivotal because Medicaid is available to people whose household income is less than 138% of the federal poverty line. Additionally, in states that have expended Medicaid coverage, there is no strict resource limit for Medicaid eligibility. In other words, a Medicaid applicant in a Medicaid expansion state can have unlimited assets (for example, cash in a bank account), but if their income is less than 138% of the Federal Poverty line, they can qualify for Medicaid.

One of the least-known implications of obtaining SSI is that it may allow the beneficiary access to food stamps. Federal law holds that if everyone in a household is eligible for SSI, then that household is eligible for SNAP, also known as foods stamps. SNAP benefits are available on a per-household basis. Thus, if a person who is receiving SSI benefits lives alone, they are automatically eligible for food stamps. Being eligible for food stamps does not negatively impact the person's eligibility for other government benefits.

A very new additional benefit for an SSI recipient is automatic status as a Qualified Medicare Beneficiary ("QMB") for purposes of Medicare. Qualified Medicare Beneficiaries receive help with the out-of-pocket costs of Medicare such as premiums, co-insurance and co-pays, and deductibles. Qualified Medicare Beneficiaries are automatically eligible for the "Extra Help" program, which helps cover the cost of prescription drugs under Medicare Part D.

Other Social Security Benefits

SSI is not the only Social Security benefit available to persons declared "disabled" by the SSA. In fact, SSI is the only Social Security benefit that is means tested, meaning it has strict asset and income requirements. If a person has substantial assets (called "available resources" by the SSA), they will likely not be eligible for SSI, but they may be entitled to other Social Security benefits.

Social Security Disability Insurance is a monthly cash benefit available to individuals who meet the definition of "disabled" according to the SSA and have worked a sufficient amount of time to be "insured" for purposes of SSDI. While the exact calculation to determine whether someone is "insured" for purposes of SSDI is beyond the scope of this guide, it is worth noting that this calculation depends on how long the person worked, how much money they made during their time working, and their age. Interestingly, being eligible for SSDI has a significant health care benefit. After 24 months of drawing SSDI, an SSDI beneficiary becomes eligible to receive Medicare (not Medicaid).

Another little-known Social Security benefit relevant to individuals who are declared "disabled" by the SSA is the "childhood disability" benefit, formerly known as the "disabled adult child benefit." This is a benefit available to adult (defined as age 18 or older) children of a worker who is currently drawing their own social security benefits. While many Americans are aware of spousal benefits available to spouses and widows of a worker or a deceased worker, few are aware of the "disabled adult child" Social Security benefit.

This benefit is available to children of any age of a worker who is currently drawing Social Security benefits so long as the disabled child is over the age of 18 and was disabled before the age of 22. The amount of the "disabled adult child" benefit is equal to 50% of the worker's benefit, or 75% of the worker's benefit if the worker is deceased. This disabled adult child benefit is also important because it allows for the disabled adult child to receive Medicare (not Medicaid) 25 months after the childhood disability payments begin.

Additionally, if a worker's spouse is caring for a minor or disabled child (of any age), the worker's spouse is entitled to a benefit equal to 50% of the worker's benefit regardless of the spouse's age. This is significant because if a spouse is not caring for a minor or disabled child, the spouse would not be eligible for spousal benefits unless the spouse was 62 (or 60 if the worker is deceased).

Veterans Benefits

While the law surrounding Veterans benefits is largely considered a separate area of elder law distinct from special needs law, a person with a condition or impairment sufficient enough to consider applying for Medicaid or a Social Security benefit should also consider applying for benefits from the Veterans Administration if they have served in the U.S. military. A person may receive VA benefits *in addition to* benefits such as SSI, SSDI, and other benefits.

VA disability compensation is a monthly, tax-free cash benefit paid to Veterans who were discharged in any way other than dishonorably who have been rated as "disabled" by the Veterans

Administration. VA disability compensation is different than SSDI in that Veterans are rated as disabled incrementally in 10% increments, while SSDI benefits are not awarded in increments. Rather, SSDI benefits are "all or nothing." However, like SSDI benefits, VA disability compensation is not means-tested, so no Veteran can be denied for having too many assets or too much income.

Aside from VA disability compensation, the VA offers other benefits for older Veterans and Veterans with severe medical conditions. These benefits are known as the VA pension, housebound benefits, and Aid and Attendance. These three benefits have more substantial eligibility requirements than VA disability compensation. While an in-depth discussion of these three benefits is beyond the scope of this guide, it is worth noting that these benefits have (1) an age or medical requirement, (2) a wartime service requirement, and (3) a "net worth" requirement, which has its own highly unique calculation that allows for strategic planning opportunities.

SPECIAL NEEDS TRUSTS

"Special Needs Trusts", sometimes called "Supplemental Needs Trusts" are trusts designed to maximize the quality of life for a beneficiary who has special needs. Conceptually, a trust is very simple, whether the trust is a special needs trust or a different kind of trust. Any trust is simply an agreement between the person or entity creating the trust and a trustee to manage certain property (assets) for the benefit of a certain beneficiary or group of beneficiaries. All special needs trusts fall into one of two categories: first-party special needs trusts (also called "self-settled" trusts) and third-party special needs trusts. Whether a special needs trust is first-party or third-party depends solely on whose assets fund the trust. If the trust is funded with assets that belong to the beneficiary themselves, then the trust is a first-party special needs trust, but if the trust is funded with assets of someone other than the beneficiary (a "third party"), then the trust is a third-party special needs trust. Vastly different rules apply to these two different types of special needs trusts.

Regardless of whether the special needs trust is first-party or third-party, one of the chief uses of a special needs trust is to allow a person with special needs to legally divest themselves of assets so that they qualify for means-tested government benefits for which they would otherwise be ineligible due to having too many assets while also retaining the benefit of those assets. Some means-tested government benefits, including Medicaid and SSI in Alabama, require that a beneficiary have no more than $2,000 in "available resources" in order to qualify. While certain resources are explicitly excepted from being considered an "available resource" (for example, a home and vehicle do not count as available resources), cash in a bank account most certainly counts toward a person's $2,000 limit.

Living with less than $2,000 to your name obviously makes for a very difficult life. A properly-drafted special needs trust gives the beneficiary the best of both worlds in that the trust allows the beneficiary to be eligible for government benefits (including those with strict means-testing) but also receive the benefit of the assets in the special needs trust to help them live the best life they can live.

Special needs trusts allow a beneficiary to maintain eligibility or government benefits by not allowing the beneficiary to legally own the asset. Therefore, any assets (such as cash) in the special needs trust are not "available resources" for the beneficiary because the beneficiary does not own those assets – the trust does. The assets in the trust (which are legally "owned" by the trust rather than the beneficiary themselves) are managed by a trustee who distributes assets in the trust for the benefit of the disabled beneficiary according to certain carefully-designed standards. Typically, special needs trusts are drafted to allow the trustee to distribute money from the trust for the benefit of the beneficiary's health, education, and maintenance. The wording of this standard is very important and is discussed later in this guide.

First Party Special Needs Trusts

First-party special needs trusts are trusts funded with assets belonging to a person with special needs. These assets are often comprised of settlements or court awards in a lawsuit (such as a vehicular or other accident) or an inheritance. These trusts can accelerate eligibility for government benefits. If a person who is receiving SSI and Medicaid receives an inheritance that results in the person owning more than $2,000, then they will be ineligible for SSI and Medicaid until they spend down that amount to $2,000 in ways that are far from optimal. However, transferring the inherited assets into a first-party special needs trust can allow for that person to become eligible for SSI and Medicaid as soon as the month after the trust is created and funded.

First-party special needs trusts have some unique technical requirements. First, the trust must be funded before the beneficiary turns 65 years old. Once the trust is funded, a trust for a beneficiary who turns 65 can no longer receive further contributions to the trust, although the trust may continue to exist and is otherwise unaffected by the beneficiary reaching age 65. Second, first-party special needs trust may only be created by the beneficiary, a court, a guardian or conservator, a parent, or a grandparent. Spouses are notably absent from this list of authorized creators. Third, the trust must be irrevocable (in other words, the trust cannot be terminated except in very rare instances) and the trust must explicitly reference the federal law that allows such trusts: 42 United States Code Section 1396(p)(d)(4)(a).

One of the most consequential requirements of a first-party special needs trust is that it must contain what is known as a "Medicaid payback provision." This is a provision that states that upon the death of the beneficiary, the state Medicaid agency is entitled to reimbursement for all funds it spent on the beneficiary's care. Notably, this payback amount includes all money spent on the beneficiary's care since the beneficiary was born regardless of when the first-party special needs trust was created. So if a beneficiary was *ever* on Medicaid, including during childhood or during their young adult years, Medicaid is entitled to recoup all costs it paid for the beneficiary's care. Given the cost of health care, this amount could obviously be very high, so caution is warranted in creating, designing, funding, and planning around first-party special needs trusts.

What can First-Party Special Needs Trusts Pay For? ("We're Going to Disney World!")

As discussed above, a first-party special needs trust allows a trustee to distribute assets for the benefit of a beneficiary according to a certain standard, which is usually for the beneficiary's health, education, and maintenance. Additionally, federal regulations require that the trustee's distributions of trust assets be for the "sole benefit" of the disabled beneficiary. The SSA adopted new regulations in 2018 that greatly liberalized what payments constitute payments for the "sole benefit" of the beneficiary.

Under the relatively new 2018 regulations, a payment from the trust need only *primarily* benefit the beneficiary, and people other than the beneficiary may benefit from the distribution *collaterally*. The 2018 regulations also featured specific changes for payments from a special needs trust to family members for caregiving, companionship, and travel. As for caregiving and companionship, the new regulations specifically state that family members may receive compensation from the trust for caregiving and companionship and incidental expenses relating to such care or companionship even if they would otherwise do so free of charge. This is a major departure from the previous rule, which required family members to be "medically trained" in order to receive compensation for caregiving. Unfortunately, many families completely miss this benefit because much of the information on the Internet is outdated and does not reflect the new more generous rule.

As for travel, the 2018 regulations explicitly allow the trust to pay family members or caregivers of the beneficiary for their travel if the travel with the beneficiary is necessary for the "safety or medical well-being" of the beneficiary. The 2018 regulations provide that "parents or caretakers" may be compensated for their travel to assist the beneficiary on vacation. The regulations provide another example of parents or caretakers accompanying a beneficiary to a museum. The regulations state that the trust may pay for the ticket to the museum.

Pooled First-Party Special Needs Trusts

There are two kinds of first-party special needs trusts: "d(4)(a)" trusts (also known as "OBRA trusts" or "Zebley" trusts) and "(d)(4)(c)" trusts (also known as pooled trusts). A (d)(4)(a) trust is a trust for one beneficiary, while a (d)(4)(c) trust is a trust established and maintained by a non-profit organization that "pools" all the assets from all the beneficiaries together for management and investment purposes but still segregates each beneficiary's own money for their own respective benefit.

The same rules largely apply for (d)(4)(a) trusts and d(4)(c) trusts with a handful of exceptions, one of which is very significant. Recall from earlier in this guide that a (d)(4)(a) trust may be funded (in other words, have assets contributed to it) only before the beneficiary turns 65 years old. Pooled trusts have no such requirement. A person may create a pooled trust for a beneficiary of any age. But some states impose a penalty for individuals age 65 or older who transfer assets to a pooled trust under federal Medicaid laws that are outside the scope of this guide. Fortunately, Alabama is one of roughly 18 states which does not impose a transfer penalty for transfers of assets by someone who is 65 years old or older into a pooled trust, making this a viable planning strategy for many disabled seniors who cannot avail themselves of a (d)(4)(a) trust because of the age limit.

Third-Party Special Needs Trusts: Even More Versatile; Even More Planning Opportunities

A third-party special needs trust is a trust created with funds from someone other than the beneficiary, often a parent, grandparent, or other family member. Third-party special needs trusts are similar to other discretionary distribution trusts often used in estate planning in that they exist for the benefit of a beneficiary but do not legally belong to the beneficiary. Just like with first-party special needs trusts, this is very important in gaining or maintaining eligibility for means-tested government benefits that have strict asset and income requirements. When properly drafted, assets in a special needs trust (whether third-party or first-party) are not considered to be owned by the beneficiary, and therefore, will not disqualify the beneficiary for government benefits such as SSI and Medicaid.

Since third-party special needs trusts are often used to obtain and preserve eligibility for government benefits, it follows that another function of third-party special needs trusts is to supplement rather than supplant government benefits. In other words, assets owned by a third-party special needs trust are used to pay for what the government benefits do not pay for, such as additional medical care not covered by Medicaid, money for education, job training, transportation (including a vehicle if the beneficiary is capable of and licensed to drive), vacations, recreational and hobby activities, and more. Whether a third-party (or first-party) special needs trust may pay for housing costs or food for the beneficiary is a very complicated question and is explored later in this guide.

While some of the technical requirements for first-party special needs trust do not apply to third-party special needs trusts, third-party special needs trusts have their own set of traps for the unwary. There are three subtle but potentially devastating traps that are unfortunately much too commonly seen in third-party special needs trusts that can completely invalidate the entire trust and strip the beneficiary of being able to use the trust at all.

The first subtle trap is including the word “support” in the discretionary distribution language of a third-party special needs trust. As discussed previously, most special needs trusts require that the trustee distribute money from the trust to pay for the beneficiary’s “health, education, and maintenance.” However, many other trusts commonly used in estate planning require that the trustee distribute money from the trust to pay for the beneficiary’s “health, education, and maintenance, and *support*”. The reason the word “support” is added by many practitioners is because the IRS holds that such this language – “health, education, maintenance, and support” – is what is known as an “ascertainable standard” which can provide some tax and asset protection benefits. Despite the fact that these tax and asset protection benefits are still attainable with the “health, education, and maintenance” language, many practitioners simply take the language directly from the IRS regulations and include it in their trusts without performing a more careful analysis.

This may appear harmless enough – simply adding the word “support” to the distribution standard in a trust. Unfortunately, simply having the word “support” likely invalidates the entire trust for a beneficiary with special needs. Courts routinely invalidate third-party special needs trusts that allow a trustee to distribute trust assets for the beneficiary’s “health, education, maintenance, and support” rather than only for the beneficiary’s “health, education, and maintenance.” The reasoning behind this rule is that if the trust can pay for the beneficiary’s support obligations, it is in effect “available” to the beneficiary, and is thus an “available resource” that counts toward their $2,000 limit. If any asset, including a trust, is considered to be an “available resource”, then the entire amount must be spent until the person has under $2,000 in available resources (this process is known as “spend down”).

Note that courts will likely invalidate the trust regardless of whether the trustee distributes assets for the beneficiary’s support or not. Regardless of the fairness of this rule or the reasoning behind it, the upshot is that simply including the word “support” in the distribution language is highly inadvisable and will likely cost the beneficiary thousands, hundred of thousands, or perhaps even millions of dollars. Unfortunately, many estate planners (including attorneys) are not aware of this legal landmine and include the word "support" in special needs trusts' distribution language, which is very dangerous.

The second technical legal landmine in third-party special needs trusts is failure to state that the trust is an "accumulation trust." This is important if the trust is a beneficiary of a retirement account such as an IRA, 401(k), 403(b), or TSP account. Generally speaking, if a trust is a beneficiary of a retirement account, it will be treated as either a conduit trust or an accumulation trust. Conduit trusts distribute income from the account to the beneficiary directly. Accumulation trusts, on the other hand, allow the trustee the discretion to either pay the income out to the beneficiary, or alternatively, to withhold the income in the trust.

It is important that a special needs trust affirmatively state that the trust is an accumulation trust rather than a conduit trust, because if the trust is a conduit trust, then the income (which would be in the form of cash) is distributed to the beneficiary automatically, which would immediately render them ineligible for means-tested government benefits if that cash resulted in the beneficiary having more than $2,000 in cash. Even more alarmingly, if a special needs trust is drafted to be a conduit trust, the fact that income from the assets in the trust must be distributed outright to the beneficiary likely renders the entire trust "available" to the beneficiary, and the entire trust would likely be considered an "available resource", resulting in the entire trust being useless.

The final technical trap concerns one of the most important differences between first-party special needs trusts and third-party special needs trusts. While first-party special needs trusts must contain a Medicaid payback provision, third-party special needs trusts do not. This makes third-party special needs trusts a much more useful vehicle to accumulate or leave large sums of assets to the beneficiary, either during the beneficiary's life or upon their death. By contrast, having large sums of money in a first-party special needs trusts can risk entitling the state Medicaid agency to any amount left in the trust after the beneficiary's death.

Because third-party special needs trusts do not require a Medicaid payback provision, they can achieve multi-generational legacy planning. Creators of third party special needs trusts have several options for designing what happens to the assets in a third-party special needs trust when the beneficiary dies. Trustmakers may decide to leave whatever assets are in the trust to the descendants (children and grandchildren) of the beneficiary, and if the beneficiary has no descendants, then to other named beneficiaries (often the other children or family members of the trust creator(s)). Another option is to grant the beneficiary a limited power of appointment, allowing the beneficiary to leave whatever is left in their trust when they pass away to whomever they wish within a limited class of beneficiaries in their own will, trust, or other writing. Obviously, this can only occur if the beneficiary has capacity to make and execute a will, trust, or other writing.

UNIQUE TAX PLANNING OPPORTUNITIES IN THE SPECIAL NEEDS CONTEXT

Estate planners helping families with beneficiaries who have special needs should consider taxes when engaging in estate and financial planning. Failing to do so is harmful for two reasons. First, as part of good estate planning, families should make sure that a family member with special needs is not burdened by having to pay or at least handle the logistics of paying taxes. Second, federal and state law offer major unique opportunities to minimize taxes for families with a person with special needs. In some cases, families with a special needs beneficiary can decrease the amount of taxes owed by a beneficiary to zero, even if their estate features a tax-deferred account like an IRA that would sustain a high tax liability if not for smart planning.

A special needs trust, whether first-party or third-party, will likely earn income. Usually, this income is earned by stocks, bonds, mutual funds, and other similar assets in the special needs trust, but may also be realized by assets such as rental property. What happens to the income generated by assets in the trust and how it is taxed depends on how the trust is drafted. A properly-drafted special needs trust will likely allow the trustee to either distribute any income earned by the trust to the beneficiary – at which point the income will be taxed to the beneficiary – or, alternatively, withhold the income in the trust, which will result in the trust paying the income tax instead of the beneficiary individually.

This brings up three issues: First, what are the tax rates for the trust, and how do they compare to the tax rates for if the income is distributed to the beneficiary? Second, if the income is distributed out to the beneficiary, how do they actually pay the taxes on it? For example, the beneficiary may not have a job or other income. Third, does distributing the income out to the beneficiary render that income (which is cash) "available" to the beneficiary, rendering them ineligible for means-tested government benefits? We will examine each of these questions in turn.

The first important question to consider is how the income tax rates for income withheld (and thus paid) by the trust compare to income tax rates for income that is distributed to the beneficiary. There are two main differences between income taxation in the trust and income taxation for the individual beneficiary: the tax rate and the standard deduction. First, the rate of taxation is different. Trust tax rates are compressed, that is, after a trust surpasses $15,200 in income (in 2024), it sustains the highest possible tax rate of 37%. By contrast, an individual would have to reach $609,350 in order to be taxed at the highest tax rate.

Second, trusts and individuals have different standard deductions. The standard deduction refers to a certain portion of income set by Congress that is simply not taxed at all. For individuals, in 2024, this amount is $14,600 for unmarried individuals. For trusts like special needs trusts, however, the amount of income that is tax-free is a measly $100. However, if the trust is irrevocable, funded before a beneficiary turns 65 years old, and all beneficiaries of the trust are disabled, the trust can obtain "qualified disability trust" status and increase its standard deduction to $4,700 in 2024. While this increase is large, $4,700 is still considerably less than the $14,600 personal deduction available to individuals. But smart planners can give their clients the best of both worlds by allowing the trustee to withhold income in the trust *or* distribute the income out to the beneficiary. This can result in the trustee using both the standard deduction for the trust *and* the standard deduction for the individual beneficiary, allowing a total of $19,300 of income each year to be completely tax-free (using 2024 figures).

Considering this difference, what should a trustee do if a trust earns income over the combined $19,300 threshold per year? What should the trustee do in that situation to minimize taxes? This is the second question raised by the relevant laws of special needs trust taxation. Recall that the tax rates for trusts are compressed (and in effect, significantly higher) than the income tax rates for individuals. A thoughtful trustee might consider distributing any income over the $19,300 tax-free threshold to the beneficiary so that the income is subjected to lower tax treatment than it would be if the trustee withhold the income in the trust. But this raises a question of how the beneficiary will actually pay that tax liability. What if the beneficiary is unemployed? Additionally, recall that means-tested government benefits often restrict a person from having more than $2,000 in available resources. Thus, the beneficiary might not well have enough cash or other assets to actually pay the tax bill.

Smart planning can achieve the best of both worlds by allowing the trust the ability to both distribute income in excess of the $19,300 threshold *and* actually pay *the beneficiary's individual tax liability* from the trust. A special needs trust should thus contain a provision allowing the trust to pay the beneficiary's personal income tax liability from trust assets. This achieves the income tax savings resulting from the tax being subjected to the individual beneficiary's lower tax rate compared to the higher rate sustained by the trust while also relieving the beneficiary from actually having to pay it, which may be impossible given the strict means-testing requirements for many government benefits necessitating that the beneficiary have very limited cash on hand.

While this strategy can result in thousands of dollars in tax savings, it presents another issue: does distributing the income out to the beneficiary render that income (which is cash) "available" to the beneficiary, rendering them ineligible for means-tested government benefits? The answer is no, so long as the trust is property drafted and carefully administered. In such a case where the individual beneficiary sustains a tax liability, and the trust pays it on behalf of the beneficiary, the trustee can send a letter to the IRS stating that the money distributed from the trust to pay the individual beneficiary's tax liability was only for tax purposes and that the beneficiary never actually came into receipt of the funds.

Using the strategies outlined above, a thoughtful trustee of a well-designed special needs trust can achieve the following major goals: (1) minimizing taxes, (2) relieving the individual beneficiary of having to actually pay any income tax that is due, and (3) preserving eligibility for government benefits while also having the trust pay for the individual beneficiary's income tax liability.

Special Opportunities to Save on Taxes for Inherited IRAs

In 2019, Congress drastically changed the law regarding the taxation of inherited retirement accounts. Before 2019, anyone who inherited a retirement account could withdraw funds from the account over their life expectancy. These withdrawals were, and still currently are, taxable at the beneficiary's individual income tax rate unless they were or are Roth accounts, which are distributed tax-free. This life-expectancy stretch resulted in most surviving beneficiaries being required to withdraw only a small amount of money from the inherited retirement account per year, allowing them to minimize their income tax liability from withdrawals from this account.

But in 2019 Congress drastically reduced the amount of time that a beneficiary other than the deceased account owner's spouse has to withdraw the funds in the account to just 10 years with the passage of the SECURE Act. Thus, a surviving child who inherits one of their parent's IRA accounts or 401(k) accounts must withdraw all of the funds in that account within 10 years of the death of the account owner (or surviving spouse). A child often inherits such accounts during the years in their life in which they are earning the most money, and thus subjected to the highest income tax rates, which exacerbates the negative effect of the SECURE Act's requirement that beneficiaries withdraw all of the funds in the account within just 10 years.

But the SECURE Act contains an exception for a beneficiary who is "disabled or chronically ill." The standard for whether a beneficiary is "disabled or chronically ill" for purposes of the SECURE Act is the same standard used by the Social Security Administration discussed previously in this guide. In cases in which a beneficiary of a retirement account is disabled, the beneficiary may withdraw the funds in the trust over their life expectancy rather than in only 10 years. This can result in tax savings, as the beneficiary will, depending on their life expectancy, be able to withdraw the funds in the account over a larger span of time than 10 years, which results in the beneficiary paying significantly less in total taxes. It is worth noting that a property-drafted special needs trust can use the benefits of this exception contained in the SECURE Act in the same way a disabled beneficiary can if they owned it in their individual name. This is yet another reason for families with a person with special needs to engage in proactive planning.

ABLE ACCOUNTS: AN ALTERNATIVE OR COMPLIMENT TO A SPECIAL NEEDS TRUST

Perhaps the biggest accomplishment of the disability rights movement in the United States is the new versatile tools it has given special needs families and planners to help people with special needs have the best life experience they possibly can. One of these new tools is an ABLE Account, which became authorized in 2014 with the passage of the federal Achieving a Better Life Experience Act.

An ABLE account is a revocable savings account that offers tax benefits as well as the ability of a disabled beneficiary to have a customizable amount of personal autonomy over their finances while also maintaining a similarly customizable set of checks and balances on the beneficiary's spending ability for their protection. Notably, federal law requires that in order for a person to have an ABLE account, they must have been disabled (according to the SSA) before age 26. Note that a person's age is irrelevant to this rule. A person can be older (or younger) than 26 and still be eligible have an ABLE account. On January 26, 2026, this law will change to allow someone to have an ABLE account if they became disabled by the age of 46 rather than 26.

ABLE accounts are easy to create. The beneficiary may create and manage the account, or a person with "signature authority" according to certain federal regulations may open and manage the account if the beneficiary is unable to do so themselves. The disabled beneficiary is considered both the beneficiary and the "owner" of the ABLE Account. This seemingly minor concept of who is considered the account owner can be important if the ABLE Account is designed to give the beneficiary some authority and autonomy to manage the account. It is their account. It has their name on it. It can be a source of pride and instill a value of ownership for a person who otherwise not be able to experience this.

ABLE accounts can allow a person with "signature authority" to either manage, co-manage, or monitor the account to protect against misuse by the account owner or potential fraud that may not be detected by the account owner.

ABLE accounts may be paired with True Link cards, which allow a beneficiary the ability to swipe a debit card connected to the ABLE account that is only valid within certain defined parameters. Examples of common parameters used in conjunction with an ABLE account include sending a text alert to a person with signature authority for the account every time the card is used by the account owner and prohibiting the card from being used at all at certain undesirable places such as a liquor store or anywhere online, where the threat of fraud is higher.

Recall that first-party special needs trusts are funded with a beneficiary's own assets, while third-party special needs trusts are funded with assets of others (often a parent or other family member of the beneficiary). In this spectrum, ABLE Accounts exist somewhere in the middle between first- and third-party special needs trusts. An ABLE Account may be funded with a beneficiary's own assets or assets from a third party.

Regardless of who contributes to an ABLE Account, no more than $18,000 may be contributed to an ABLE Account each year, subject to one exception. If an ABLE Account owner (recall the beneficiary is considered the owner of the ABLE Account) is employed, the owner may contribute – in addition to the $18,000 per year allowed by law – an amount equal to the lesser of the federal poverty line for a single person (in 2024, this amount is $14,580) or the account owner's compensation for the year. Using this rule and the rule allowing people or entities other than the Account owner to contribute up to $18,000 per year to an ABLE Account, ABLE Accounts can potentially be funded with up to $32,580 per year as of 2024.

While contributions to ABLE Accounts are not tax-deductible for purposes of federal income taxes, many states, including Alabama, offer income tax deductions for state income tax purposes. In Alabama, a person may deduct up to $5,000 per year from their Alabama state taxable income for contributions to an ABLE Account, and married couples may deduct up to $10,000 for contributions to an ABLE Account. ABLE Accounts also feature tax benefits for the account owner (recall that the account owner is the disabled beneficiary). So long as the assets in the ABLE account are used for "Qualified Disability Expenses", distributions or withdrawals from the ABLE account are not taxable at all. Additionally, if there is any growth in the assets in the account, that growth is completely tax-free. Generally, distributions or withdrawals from the ABLE account for an owner's health, education, or maintenance qualify as "Qualified Disability Expenses", making authorized distributions between both first- and third-party special needs trusts and ABLE accounts very similar. However, there is one important exception to this general rule, which is discussed immediately below.

How ABLE Accounts Allow a Beneficiary to Preserve More Money While Also Preserving Eligibility for SSI and Medicaid

Recall from this guide's earlier discussion that eligibility for SSI is particularly important because if a person receives just one dollar of SSI benefit, then that person is automatically eligible for Medicaid. Recall also that federal regulations allow a person to have only $2,000 in available resources to be eligible for SSI, and that cash is an available resource. Thus, if a person has more than $2,000 in their bank account, they will not receive SSI (and they will not be categorically eligible for Medicaid in states like Alabama, which have not expanded Medicaid coverage). ABLE Accounts provide a significant exception to this rule.

Federal law allows ABLE accounts to hold up to $100,000 and still allow the account owner to be eligible for SSI (and thus Medicaid). To illustrate how impactful this is, consider the following hypotheticals: if a person has $100,000 in an ABLE account, they can still be eligible for SSI. But if a person has $100,000 in a bank account that is not an ABLE account, they will not be eligible for SSI (and thus Medicaid) until they spend down $98,000 so that they have only $2,000.

How ABLE Accounts Solve the ISM Problem

ABLE accounts can solve another problem related to SSI and Medicaid. Recall that SSI payments are, in theory, supposed to cover housing and food costs. This is important because of the concept known as "in-kind support and maintenance" ("ISM"). Federal regulations hold that if a beneficiary receives food or shelter – or money for food and shelter – whether from another person (such as a parent or grandparent) or a trust (including a special needs trust), then their SSI benefit is reduced by about 33% to account for the fact that the beneficiary is receiving food and shelter from another source. If a person is receiving the maximum monthly benefit of $943 per month, then their SSI benefit would be reduced to roughly $600 (the exact calculation is slightly more complicated but not necessary to understand the concept). ISM includes a situation in which an SSI beneficiary lives with family members, including parents, since the family member is providing housing to them presumably free of charge.

This problem, which I will refer to as the "ISM problem", can be dealt with in 3 ways. First, an SSI recipient can simply refuse to receive support for housing or food in order to obtain and preserve the maximum SSI benefit. Second, an SSI recipient could take the opposite approach: they could receive food and shelter from another person or a trust (including a special needs trust) and simply accept the 33% penalty for providing this ISM or pay rent in an amount approved by the SSA. This is a popular approach, since the benefit provided by providing a beneficiary food and housing is often much more valuable than the roughly $300 the beneficiary might forego by accepting the housing or shelter benefit.

However, when a beneficiary receives less than the maximum SSI benefit, which can occur if they earn income – whether through dividends, gifts from others, or their own job, the question of whether to accept housing or food benefits from another person or a trust becomes a much more delicate and precarious analysis. This is because if the beneficiary's SSI benefit is ever less than one dollar per month, they will lose the automatic Medicaid eligibility available through their status as an SSI beneficiary. This is extremely consequential in states like Alabama which have not expanded Medicaid because without SSI, Medicaid eligibility is very difficult. Thus, whether to accept housing and food costs and knowingly accept the 33% reduction in SSI or pay rent is a fact-intensive analysis that requires care, attention to detail, and knowledge of the rules.

Interestingly, ABLE accounts provide a third solution to the ISM problem. This is because federal regulations allow an ABLE account to pay for food and shelter without subjecting the account owner (the disabled person) to any ISM penalty. Special needs trusts should be drafted so as to explicitly allow the special needs trust to fund and transfer money and other assets to ABLE accounts. This creates a clever strategy in which a special needs trust can effectively pay for housing and food costs for a beneficiary without subjecting the beneficiary to the reduction in SSI benefits and possible corresponding disqualification for Medicaid. Under this clever arrangement, the special needs trust pays the ABLE account (in accordance with the applicable federal regulations concerning contributions to ABLE accounts), which then pays for housing or food costs for the beneficiary (in the form of rent, mortgage payments, utility payments, garbage removal, or other like expenses).

The Downside of ABLE Accounts: The Return of the Medicaid Payback Provision

At this point, other than the limited amount that can be contributed to them ($18,000 per year and possibly up to $32,580 if the beneficiary earns money through their own employment), ABLE accounts appear to be a tool that nearly everyone should use, considering all of their advantages. But there is one significant drawback to an ABLE account. Like first-party special needs trusts, ABLE accounts require a Medicaid payback provision, meaning that after the death of the beneficiary, Medicaid is entitled to be paid back for the money it spent on the ABLE account owner's care from the funds remaining in the ABLE account.

However, there are two interesting wrinkles to the Medicaid payback provision required for ABLE accounts. First, unlike the Medicaid payback provision required in first-party special needs trusts, which applies to all funds Medicaid has spent on the beneficiary's behalf since they were born, Medicaid payback provisions in ABLE accounts require Medicaid to be paid back for all funds the agency spent on a beneficiary's care since the inception of the ABLE account. This can result in Medicaid being entitled to a smaller amount than if the beneficiary had a first-party special needs trust.

The second difference between the Medicaid payback provisions required for ABLE accounts and the Medicaid payback provisions required for first-party special needs trusts is that each state's Medicaid agency is merely *allowed* to seek reimbursement for funds it provided for the beneficiary's care. In the context of first-party special needs trusts, states are *required* to seek reimbursement (although in practice, the states seek reimbursement with varying levels of aggression). Despite this difference, special needs planners and families should keep in mind that ABLE accounts are still a rather new legal creation, originating in 2014. If a state has the option to recoup funds from an ABLE account that it spent on a beneficiary's care, it has the legal right to do so. Thus, caution is warranted whenever ABLE accounts garner a significant balance.

Without question, the requirement that ABLE accounts contain a Medicaid payback provision should be considered before creating one and contributing money to it. However, with watchful, close management, and perhaps with help from a special needs law attorney, ABLE account balances can be strategically managed so that Medicaid's payback provision is minimally impactful for the beneficiary's family. For example, an ABLE account might be akin to a checking account in that it is used for the account owner's everyday expenses and does not often carry large balances. This way, when the account owner passes away, the amount of money Medicaid can recoup from the ABLE account is minimal. It is also worth noting that an ABLE account owner (or person with signature authority) can "rollover" an ABLE account to another family member beneficiary who meets the SSA's definition of "disabled." In any event, the Medicaid payback provision required by ABLE accounts renders ABLE Accounts a poor tool for accumulating or holding large assets, but a good tool for holding an account owner's everyday "spending money."

OTHER TOOLS: POWERS OF ATTORNEY, GUARDIANSHIP AND CONSERVATORSHIPS, AND SUPPORTED DECISION MAKING

The final set of tools in the special needs law attorney’s toolbox are powers of attorney, guardianships, conservatorships, and supported decision making. Powers of attorney, guardianships, and conservatorships are much more well-known than all the other tools in the special needs planning toolbox discussed previously in this guide, while supported decision making is one of the least known simply because it is very new.

A power of attorney is one of the most important documents that any American citizen can have. It allows someone to speak, sign, and act for the signer of the document (called the “principal”) if the principal is ever unable to speak, sign, and act for themselves. This may occur if the principal is in an accident or develops a physical or mental impairment that renders them unable to manage their own affairs. The principal can decide who this surrogate decisionmaker is in the power of attorney they sign. Powers of attorney can allow someone to make decisions regarding finances (often called a “financial power of attorney”) or health care (often called a “health care power of attorney”) on the principal’s behalf. Powers of attorney can confer both financial and medical powers in one document, although this is uncommon.

If someone is ever completely incapable of managing their own affairs, and they have not executed a valid, legal power of attorney, the only way that someone can act for them is by obtaining a guardianship or a conservatorship over the incapacitated person. In cases in which a person lacks capacity to manage their own affairs and they have never executed a power of attorney, a guardianship and/or a conservatorship is often required to do things like manage their assets or obtain health care for them. A guardianship allows a legally-appointed person (called a guardian) to manage the health affairs of the incapacitated person, while a conservatorship allows a legally-appointed person (called a conservator) to manage the financial affairs of the incapacitated person.

Guardianships and conservatorships are proceedings in court. They cut off the incapacitated person’s rights to manage their own affairs and vest those rights in a person appointed by a judge. These proceedings are not sealed from public view or access. Anyone can walk into their local court (usually called a probate court) and look through any entire guardianship and/or conservatorship proceeding. Guardianships and conservatorships are neither fast nor cheap. In some sad situations, guardianships and conservatorships may be contested by another member of the family, leading to a heart-breaking legal fight over who may legally manage the incapacitated person’s health care or finances. These cases are some of the most difficult for a special needs law attorney to handle.

As one might infer at this point, guardianships and conservatorships are viewed as a “last resort” by special needs law attorneys. Sometimes these proceedings are necessary, and they serve the above-described purposes well when they are needed. But they should only be explored when no other legal option exists. There is unfortunately a great deal of misinformation (and perhaps malfeasance) regarding when a guardianship or conservatorship is needed. Oftentimes, families with a person with special needs have been told by someone who is not a special needs law attorney or read on the Internet that when their child turns 19 (and becomes a legal "adult" in the state of Alabama), they need to obtain a guardianship. This view is incorrect, backward, and harmful. A guardianship and conservatorship should be viewed as a last resort.

As difficult, expensive, and slow as guardianships and conservatorships are, there is good news: they can be avoided with a properly-drafted power of attorney. This raises the issue of whether a person has the requisite legal capacity needed to sign a legal document such as a power of attorney. While the nuances of the requisite legal capacity to sign legal documents are far beyond the scope of this guide, there are 3 important points to know. First, the level of capacity required depends on the task the person is doing. For example, the legal capacity required to make and sign a last will and testament is much higher than the legal capacity required to consent to a certain family member being able to access a person's medical records otherwise protected by federal law.

Second, whether a person can sign a legal document – no matter the document and no matter what diagnosis a person has or does not have – is a decision for the attorney to make. Each state's Rules of Professional Conduct, the American Bar Association, and the National Academy of Elder Law Attorneys (which has a significant wing devoted to special needs law study and scholarship) have each made this very clear. While attorneys must make this decision, they are not diagnosticians, and accordingly, the attorney is empowered to refer the client to such a professional if they choose.

Thus, a special needs law attorney will begin their analysis by focusing on what the person with special needs *can* do rather than what they *cannot* do. If a person (whether they have special needs or not) can sign a health care power of attorney, and it is appropriate to do so, it is almost always preferrable to a guardianship. It is much cheaper, faster, and private than a guardianship, and it preserves the person's autonomy over their affairs in a way a guardianship cannot. The same is true for financial powers of attorney – they are almost always preferrable to conservatorships for the same reasons.

The third and more powerful point is that just because a person has special needs or is declared "disabled" by the SSA does not necessarily mean that they cannot sign a legal document such as a financial or health care power of attorney. This is one of the most damaging misconceptions that exists in special needs law. Rather, the law holds that the attorney should engage in a specific, fact-intensive analysis to determine what legal capacity a person has. Diagnoses and medical information are relevant, but not dispositive, in this analysis. Thankfully, by reading this, you now know of this harmful misconception, and you may join the author of this guide in the fight against this widespread misinformation.

Supported Decision-Making

While powers of attorney are the most well-known alternative to guardianships and conservatorships, the concept of supported decision-making has rapidly proliferated through the special needs community and through many state legislatures. On August 1, 2023, a new law known as the Colby Act became effective, allowing Alabamians to engage in supported decision-making. Supported decision-making exists somewhere between guardianships and conservatorships on the one hand and powers of attorney on the other.

Recall that guardianships and conservatorships should be viewed as a last resort due to their numerous drawbacks. But what if a person does not have the requisite legal capacity to sign a power of attorney? Or, what if a person is able to sign a power of attorney, and does so, but still wants to maintain some decision-making authority and simply wants to name someone who can *help* the person make and communicate *their own* decisions, rather than just delegating the decisions to someone else? In situations like these, supported decision-making provides a helpful tool to achieve these goals.

Supported decision-making allows a person with special needs to legally name other individuals (called "supporters") to help them make and communicate decisions about any number of subjects. For example, a person might nominate a certain person or people to help them learn about and draw conclusions about where the person wants to live, how they spend their time, what they spend their money on, their food and clothing, or help them with government benefits. Supported decision making can exist harmoniously with a power of attorney. While a power of attorney is an important document for anyone to have, supported decision-making is different than a power of attorney in that it *empowers* the signing person (the principal) to maintain significant autonomy over their own health, finances, and life. It keeps the person with special needs in the driver's seat of their life – with the help of the people whom they choose – instead of relegating them to the passenger's seat of their own life.

Supported decision-making is a very new concept not only in Alabama, but also in the United States. Accordingly, there are not as many resources available to help families learn about this exciting new area of law. The author of this guide has developed a custom supported decision-making agreement that you may have for free. Simply email or call our office and ask for it, and we will either email or mail it to you for free.

Thank You for Reading!

On behalf of our law firm, I sincerely hope you found this guide helpful. Feel free to let us know what you think by calling or emailing our office at any time. We hope to see you around!

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