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How to plan your estate if you have a special needs child

Almost three million children in the U.S. between the ages of five and 15 have special needs, according to the latest Census figures. Parents of these children need to use extra care in planning their estates.

For most people, estate planning is about making sure your assets go where you want them to, and minimizing inconvenience and taxes along the way. But parents of special needs children face an additional challenge because they have to make sure that their children will continue to be cared for, even if they have trouble caring for themselves.

One of the best ways to do this is with a "special needs trust."

Many people with special needs are eligible for government programs that finance their basic support needs. This includes health insurance coverage and direct cash payments through the Medicaid system and Social Security. The problem is that people are eligible for these programs only if they don't have enough assets to pay for those items themselves. If a person with special needs has assets in his or her name, the government wants the person to use those assets before it will provide support.

This means that if parents or other relatives leave money directly to a child with special needs, this can have the effect of disqualifying the child from Medicaid or Supplemental Security Income. Leaving money to such a child may actually harm the child, since those benefits, including medical support, will potentially be forfeited.

The typical solution is to put the money into a trust with the child as the beneficiary. If the trust is properly set up, it doesn't count as the child's asset, and it won't disqualify him or her from benefits.

The trustee can be instructed to use the trust

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assets to pay for things that aren't covered by government programs. For instance, the trust money can be used to provide travel or cultural opportunities. It can be used to purchase sports tickets, consumer electronics, and other items that can enhance the child's quality of life.

For this reason, these trusts are sometimes called "supplemental needs trusts."

You can create a trust now and fund it, so that your investments will grow and become available later when the child needs them. You can also leave money to the trust in your will. Many parents buy life insurance and name the trust as the beneficiary, so they can be sure the trust will be well-funded after they're gone.

If the child receives money directly from another source – for instance, proceeds from a lawsuit – it may be wise to structure any settlement so that the proceeds go to the trust rather than to the child directly.

The exact rules for these trusts can be complicated, and they vary from state to state and also depend on the source of the funds.

If you set up a special needs trust, keep in mind that it's not only your own estate plan that needs to be amended. If grandparents or other relatives have wills that leave money to the child, you'll want to ask them to change their plans as well, so the money goes to the trust. You'll also want to change any beneficiary designations on retirement accounts and name the trust instead.

Another thing to consider is who should be the trustee. Parents and other relatives can be trustees, although if you're not comfortable with handling investments you might want to name a financial institution, or at least enlist the help of a financial advisor.

If you're the trustee, you'll need to be careful when making disbursements always to give the money to a third party. For instance, if you're buying travel tickets, you'll want to pay the provider directly rather than giving the money to the child – because giving the money to the child could affect his or her eligibility for government benefits.

Also, if you're the trustee, you'll want to consider who will be the successor trustee if something happens to you.

If you set up a special needs trust, it's not only your own estate plan that needs to be amended. If grandparents or other relatives have wills that leave money to the child, you'll want to ask them to change their plans as well. You'll also want to change any beneficiary designations.

Most parents of special needs children aren't planning properly

Some 62% of parents with special needs children have no plan at all to cover the cost of caring for their children when they can no longer do so, according to a survey by the Hartford Financial Services Group.

And even among parents who *have* a plan, many are making big mistakes. About half plan to leave money to their child in a will and some 58% name their child as an account beneficiary, both of which can disqualify the child from government benefits. Only 25% have created a special needs trust.

Among parents of teenagers with special needs, only 46% have a life insurance policy, even though a reasonably priced policy with a trust as the beneficiary can make a huge difference in a child's life after a parent is gone.

One reason why so many parents make mistakes: Only 16% of those with a plan consulted an attorney or other advisor when creating it.

If you name an institution as a trustee, you might want to write a detailed letter telling the trustee about your child and what he or she likes and dislikes. This can be very helpful if something happens to you and you're not around to provide guidance. The letter can be updated as often as necessary.

If you can't find an appropriate trustee or if your trust is small in the beginning, another possibility is a "pooled" trust managed by a non-profit organization that focuses on disability issues. These trusts gather assets from many families and pool them together for investment purposes.

On a separate note, parents of minors with special needs should be sure to create powers of attorney and guardianship documents that allow them to act as the child's agent after the child turns 18. Otherwise, you might run into difficulties when making financial and health-care decisions for your child later on.

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Making gifts or loans to your children? Be sure to mention them in your will

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Many parents make gifts or loans to their children. Often they give more money to one child than to others, perhaps because one child has a greater need.

If you do make a significant gift or loan to one of your heirs, you should modify your will to address it.

The reason: If something happens to you, it might be unclear to your heirs what the effect of the gifts or loans should be on their inheritance. In some families, this kind of uncertainty can lead to family battles and even a legal challenge to the will. But even if this doesn't happen, some children might be quietly offended or simply uncertain, and you probably want to avoid that if possible.

So if you are leaving some children more assets in your will than others as a result of gifts made during your lifetime, it's a good idea to explain your reasoning in your will. If you're leaving all your children equal shares in spite of having given some of them more gifts than others in your lifetime, you should say that as well – so there's no question whether the lifetime gifts should be treated as an "advance" on their inheritance.

What if a loan is outstanding at the time you die? You might want to make clear that any such loan doesn't have to be repaid, and doesn't affect the distribution in your will. On the other hand, if you want the loan to be treated as an advance against an inheritance, you should make that clear.

If you want a loan to be repaid after your death or to be treated as an advance against an inheritance, then you should have a written loan agreement with your child. You might also want to specify in the agreement that any forgiveness has to be in writing, so your child can't claim after you die that at some point you forgave the loan.

New Nevada law may help you save taxes, protect assets

A new law in Nevada could benefit people all over the country who want to reduce estate taxes and protect assets from creditors.

The law allows anyone in the U.S. to create a "restricted" limited partnership or limited liability company in Nevada.

In general, putting assets into an LP or LLC can be a good idea. You can then give membership units, or shares, in the LP or LLC to your heirs each year. Ordinarily, you can't give anyone more than $13,000 a year without incurring gift tax. But because the shares are worth less than an equivalent amount of the underlying assets, each year you can give your heirs shares that represent considerably more than $13,000 worth of assets.

Why are the shares worth less? Their value is discounted for two reasons. One, the value of a share is worth less than the value of the assets because it's a lot harder to sell a share in a partnership than it is to sell underlying assets such as stocks or real estate. And two, if your heirs are minority shareholders, they have no control over the handling of the assets or their distribution to shareholders.

In other words, putting assets into an LP or LLC can result in a considerably discounted value for tax purposes.

Here's where the Nevada law comes in. The law says you can set up an LP or LLC and require that no distributions will be made for up to 10 years. (That's far longer than any other state allows.)

If no distributions can be made for many years, then the value of the shares will be discounted even further – which means you can give away even more shares each year without incurring a tax.

Another advantage of tying up the assets for up to 10 years is that it protects them from creditors. It's much harder for creditors to demand that an LP or LLC make a distribution to satisfy a debt if doing so is contrary to state law.

If you already have an LP or LLC in another state, the law allows you to move it to Nevada to take advantage of the restrictions.

The law took effect on October 1, 2009. Because the law is so new, there are a few questions and it's not absolutely clear that it will work exactly as planned. But as with many things in Nevada, it's a gamble that could pay off big.

You don't have to live in Nevada to take advantage of the state's new law on LLCs and limited partnerships.

Make sure your loved ones can find your passwords

It can take a long time and a lot of work to persuade a company to turn over passwords of a deceased relative.

Years ago, when someone passed away, their loved ones could often access all the documents they needed with a simple key to a safe deposit box.

Now however, many aspects of people's lives – both financial and personal – are online in places accessible only by password. This includes e-mail accounts, PayPal accounts, online banks and brokerages, automatic bill-paying arrangements, and even Facebook pages and photo collections.

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When a person dies, access to these accounts and contacts can be lost if loved ones don't know about them. Even if they do know about them, it can take a long time and a lot of work to persuade a company to turn over user-names and passwords of a deceased relative.

And it can be even harder if the relative is still alive but has become incapacitated.

So it's a good idea in preparing your estate planning documents to let people know any passwords they'll need in order to access these parts of your life – and to update this list regularly.

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