-Living…Not Just Surviving-

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SPECIAL NEEDS TRUST FUND MANAGEMENT

Because of the very nature of the Special Needs Trust **(**SNT), once it has been funded a new problem arises: namely, the management of the trust funds during the lifetime of the special needs beneficiary.

The main problem we confront is that of income taxes due to the high tax rates on this kind of trust. For example, the highest current federal tax bracket of 35 % is reached at only $11,350 of taxable trust income compared with $379,150 for either a single or joint filer. These high tax rates were imposed by Congress as a way to discourage the use of trusts as a way to accumulate funds. In other words, trusts are intended to be used as a way to manage funds and pay out corresponding income to the beneficiary each year so that minimal amounts of income are retained, and therefore not taxed, in the trust. All distributed trust income will accrue to the trust beneficiary, presumably in a much lower tax bracket than the trust.

In the case of an SNT, however, a unique problem arises in that the trust is to pay out income "only" when needed to "supplement" funds provided from other sources – usually government benefits such as SSI, SSDI and Medicaid. **So the ultimate dilemma that arises with SNT's is how to manage the funds in a way that does not consume earnings and growth with trust income taxes?**

Possible tax favored investment options are tax free bonds, growth stocks, tax deferred annuities, tax managed mutual funds, and, finally, indexed mutual funds. Depending upon the needs of the special needs beneficiary, any or all of these could be used in a diversified trust fund portfolio.

What should ultimately help determine the specific allocation among the above investment options is to first assess the needs of the special needs beneficiary, both now and in the future. If we use an example, we can see more clearly just how such an assessment would be carried out.

Let's assume that $150,000 has been placed into an SNT for the benefit of a 50-year-old special needs beneficiary. Let's further assume that it is determined that only $2,400 is needed each year for supplemental needs, adjusted each year for a 3% cost of living, and that a 7% gross investment yield will be realized. This results in a fund need of $60,000 to generate a 4% real rate of return (7% less 3% inflation). The remaining $90,000 of trust funds are not needed currently to generate the expected supplemental income needs so they can be devoted to growth-oriented investments. An allocation go to the among tax managed and indexed mutual funds, or tax deferred annuities, would be appropriate for this remaining $90,000.

As consequence of this basic investment strategy, income tax liability to the trust would always be minimal. And since the income beneficiary is disabled and has little, if any, taxable income, the taxes due from distributed trust income would likewise be minimal. In the future, if additional income is needed from the trust, assets can be sold at capital gains rates in the case of the mutual funds, or withdrawals can be made from the annuities at ordinary income tax rates to the beneficiary.