Funding a Special Needs Trust With Life Insurance

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Funding a special needs trust with enough money to pay for the needs of a child with special needs can be a daunting task for many families. The costs of providing a home and care, as well as a care manager to take the place of the parents when they are no longer around, exceed the resources of most families. A solution for many parents is to fund a special needs trust with a form of life insurance. In these instances, a parent will take out a life insurance policy on his or her life to ensure that once the parent is gone, monies will be available to care for the special needs child.

The benefits of funding an SNT with life insurance are many. Life insurance proceeds can be paid to an SNT free of taxation. Life insurance also typically pays proceeds in a short time period and so can ensure that the special needs child has the cash needed to provide for her long-term care. Further, a paid-up life insurance policy will guarantee an SNT future funding while keeping the parents' estate intact for other family members.

The various types of life insurance that can be used to fund an SNT include:

> **Term Life Insurance**: Term life insurance provides coverage for a defined period of time, normally the time in which premiums are paid. After that period ends, the policyholder can choose to continue to pay for the policy or end coverage. A term policy pays a benefit should the policyholder die within the period covered under the policy. The premiums for term policies typically increase each year as the insured gets older or are level for a specified number of years, such as 20, after which the policies are typically dropped due to the steep increase in premiums at the end of the guaranteed term.
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> **Whole Life Insurance**: Unlike term insurance, a whole life policy lasts for the policyholder's entire lifetime and provides both death benefit protection and cash value. Part of the premium paid by the policyholder goes into a cash account which accumulates over time. The cash value tends to accumulate at a higher rate when the policyholder is younger and lessens as she ages. Further, many of these policies pay dividends, which add additional value to the policy. Policyholders may withdraw money from their whole life policy but will be charged a fee or, in the case of a loan, the holder will be obligated to pay back the borrowed amount with interest.
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> **Universal Life Insurance**: A universal life policy permits the policy holder to adjust death benefits and premium payment to fit any change of circumstances for the holder. Premiums can be credited to an accumulation fund from which premium costs are deducted and to which interest is credited.

Variable Life Insurance: The variable life insurance policy's cash value is tied to the performance of financial markets.

Survivorship Life Insurance: Also known as a second-to-die life insurance, this policy is taken out on the lives of two people and provides benefits only upon the death of the second insured person.

Many financial planners recommend survivorship life insurance for funding an SNT trust due to:

- The lower cost of the policy
- The funds become available upon the death of the second insured, when the funds would be most needed.
- Underwriting (i.e., the process by which an insurance company determines the insurability of the policyholder and rate of premiums) of the policy is less strict since two lives are being insured.
- Policies are available as either whole or universal life .
- Estate taxes can be delayed until both parties die.

Is a Survivorship Policy a Good Idea?

John W. Nadworny and Cynthia R. Haddad, certified financial planners with special needs family members, advise their clients to use care when funding an SNT with survivorship life insurance. For those families that have financial constraints, a survivorship policy could leave the living spouse with "significant financial hardship."

Instead, Nadworny and Haddad advise clients to consider purchasing term life insurance covering each spouse, with the SNT as the beneficiary. When the client, normally the parent of the special needs child, has more disposable income, he can convert coverage to a permanent policy.

Laurence T. Tract, Esq., an attorney specializing in insurance law at AIG, believes that survivorship insurance should never be used to fund an SNT. "There is no guarantee that the survivor will provide for the beneficiary. The survivor may dilute the assets, give them to another favored party and may not have the ability or inclination to set up an SNT," says Tract.

While funding an SNT with life insurance may be the best bet for many families, it is essential to ensure that all factors are considered by consulting with either a financial planner or attorney who devote a significant part of their practices to working with individuals with special needs and with their families.

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