Client and Friend Newsletter

November 2023

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2024 – What you will see and not see

The year 2024 will bring several 'increases:'

- There will be a 3.2% cost of living adjustment for social security benefits.
- The federal annual gift tax exemption will increase from $17,000 to $18,000.
- The federal estate tax exemption will increase from $12.92 million to

More Info on page 2-3

What is the difference between a First-Party Special Needs Trust versus Third-Party Special Needs Trust?

By Beth A. McDaniel

A special needs trust allows a disabled person to retain assets – or enables a third person to provide assets for the sole benefit of a disabled person -- without the disabled person's losing losing their eligibility for important needs-based benefits. A special needs trust is a discretionary trust – the disabled person cannot direct distributions or serve as Trustee of such a trust. Typically, the only limited 'power' the disabled person may have regarding their trust (per the trust's terms) is a 'testamentary power of appointment.' This power allows the beneficiary to stipulate, through a provision

Continued on pages 3-7

When the Death of a Spouse Occurs

By Beth A. McDaniel

One of the most stressful, if not the most stressful, life altering events an individual can experience is the death of a spouse. Aside from obvious impacts, there can be some not so obvious impacts:

Continued on pages 7-9

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...$13.61 million*
• In our state, county recording fees will increase by $100 for any recordings occurring after January 1, 2024

One thing which will not increase in 2024 is the Washington estate tax exemption, which will remain fixed at $2.193 million. This rate has been unchanged since 2018. To provide historical context, on February 5, 2005, a Washington Supreme Court ruling effectively repealed the state's estate tax. Subsequently, new legislation was introduced establishing a $1.5 million exemption for Washington state residents who passed away after May 17, 2005. For Washington residents passing away after January 1, 2006, the exemption increased to $2 million, indexed to inflation.

The consumer price index used by Washington State Department of Revenue ("DOR") to calculate inflation-based estate tax increases was originally tied to the Department of Labor's consumer price index for Seattle-Tacoma-Bremerton. However, in 2018, this consumer price index was replaced/renamed as the consumer price index for Seattle-Tacoma-Bellevue. Since the law specified 'consumer price index for Seattle-Tacoma-Bremerton,' according to DOR, no automatic 'indexing' for inflation can take place. I am not aware that there has been any proposed legislation to rectify the issue, and it is my understanding that DOR has the authority to make the correction without a legislative remedy. I was informed by one of my colleagues, that this issue is considered 'dead' due to competing interests surrounding the issue including a push to do a complete tax overhaul in our state.

Disclaimer: this newsletter is informational only and should not be construed as legal advice.

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In the meantime, it is advisable to explore estate planning strategies to reduce your taxable estate, particularly if you are married, as estate planning makes it possible for each spouse to leverage their $2.193 million Washington estate tax exemption.

*Please note that unless Congress acts before January 1, 2026, the federal estate tax is slated to sunset and be halved, subject to inflation. Married couples with estates exceeding $6 million should be aware that it is important file a federal estate tax return following the first spouse's death – even though no tax would be owed following the first death – as this step allows the survivor spouse to make use of the unused estate tax exemption of their deceased spouse through a concept called 'portability.'

Cont: What is the difference between a First-Party Special Needs Trust versus Third-Party Special Needs Trust?

in their Will, the final disposition of any remaining trust assets upon their passing.

First Party Special Needs Trust.

• A first-party special needs trust is funded with the assets of the disabled person.

• Other names for a first party trust include 'd(4)(A) special needs trust,' which cites to the Social Security code provision authorizing such a trust or a 'self-settled special needs trust.

• Common reasons for establishing such a trust include the disabled person's receipt of inheritance, the disabled person's being directly named as a beneficiary of a non-probate

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asset like life insurance or an IRA, or the disabled person's receiving funds from a settlement or lawsuit.

- A first-party special needs trust can be established by the individual (or their agent), a guardian, parent, grandparent, or the court.
- The beneficiary must be younger than age 65 when the trust is established, and the trust must be funded before the beneficiary turns age 65.
- The beneficiary's social security number can serve as the first-party special needs trust's tax identification number.
- Upon the trust's termination, which occurs at the earlier of the beneficiary's recovery from disability or their passing, the state(s) must be reimbursed.
- The only expenses which can be paid ahead of the state(s) upon the trust's termination are taxes, liabilities incurred prior to the beneficiary's passing, and administrative expenses.
- It is worth noting that the beneficiary's funeral expenses cannot be paid prior to the state(s) being reimbursed following the beneficiary's death. This has led some of my colleagues to give such trusts the morbid, tongue-in-cheek nickname of 'stinky body trusts' (not pleasant, but a memorable). Consequently, it is important to pre-pay for funeral services expenses from the trust while the beneficiary is still alive.

A useful resource for Trustees of first-party special needs trusts is the Special Needs Trust Alliance's Trustee handbook which can be found for free on their website (specialneedsalliance.org).

Third-Party Special Needs Trust.

- A third-party special needs trust is created by a third-party for the

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benefit of a disabled person ("beneficiary") and funded by a third-party's assets.

• A Third-Party Special Needs Trust can be a stand-alone trust for gifting purposes, enabling contributions for the benefit of the disabled person; more commonly, however, third-party special needs trusts are 'testamentary,' funded with inheritance through trust language in a Will or a revocable living trust.

• Upon the establishment of a trust for a disabled family member, it is helpful to provide family members with a letter which states the name of the trust so they may leave assets intended for the disabled family member to the disabled family members' third-party special needs trust. Please let us know if you would like a sample letter to send to family members.

• Unlike a first-party special needs trust, the beneficiary's age at the time of the trust's creation does not have to be under the age sixty-five.

• Additionally, the Trust does not need 'payback provisions' to the state(s). The creator of the third-party special needs trust determines the eventual final distribution of the trust's assets, upon the earlier of the end of the beneficiary's disability or death.

Things to Make Note of For Both First-Party and Third-Party Special Needs Trusts:

• Special Needs Trusts, whether first-party or third-party, cannot be used for food or shelter for SSI recipients without affecting their monthly benefits.

• Shelter includes utility expenses.

• Using funds from a special needs trust for shelter expenses will cause a one-third reduction to SSI payments. That said, it is important for the trust to give the Trustee flexibility to use trust funds for

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shelter as it may be in the best interest of the beneficiary.

- If a special needs trust's assets are used for food, the SSI payment deduction is dollar-for- dollar.
- If the beneficiary receives Section 8 housing, any distribution from either type of special needs trust that is not a medical expense will be considered income to the beneficiary, leading to an increase in the beneficiary's rent. To avoid this, if the beneficiary was disabled before the age of twenty-six, the Trustee can utilize trust funds to establish an 'ABLE account.' There would be no rental increase if qualified. non-medical expenses are paid from an ABLE account.
- To learn more about ABLE accounts, a helpful resource is the Able National Resource Center (ablernc.com). Note: many states have ABLE accounts, including Washington (washingtonable.com), but you do not have to use Washington's able account if you prefer the offerings of another state.
- Both first-party special needs trust and third-party special needs trust can be designated as a beneficiary of an IRA account.
    - It is important that the trust contains provisions that the required minimum distributions ("RMDs") can 'accumulate' in the trust. Otherwise, the RMDs will be treated as income.
    - Unlike 'designated beneficiaries' who must take the RMDs within ten years of the IRA owner's death, disabled individuals are considered 'eligible designated beneficiaries' who can take the RMDs over their actuarial life. The RMDs would be treated the same way if the beneficiary is a special needs trust. Having a third- party special needs trust be the beneficiary of an IRA is preferrable.

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- If a disabled person is named as the beneficiary (rather than the trust), the hope is that they are under the age of sixty-five, as per IRS private letter ruling, it is possible for the disabled beneficiary's inherited IRA to be rolled over to an inherited IRA owned by a first-party special needs trust. This process requires a knowledgeable advisor and proactive IRA administrator
- as the rollovers from the decedent's account to the disabled beneficiary's inherited IRA and then to the inherited IRA owned by the first-party special needs trust must occur within the same month and be completed by the first of the following month. Otherwise, the IRA account will be considered an asset of the disabled individual, jeopardizing their Medicaid and/or SSI eligibility.

Cont: When the Death of a Spouse Occurs

• I think of the woman who was frustrated as Comcast would not allow her to put the ownership of the account I her sole name as she did not know answer to a 'secret question,' the name of her husband's childhood best friend.
• The shock of a client when her bank abruptly cancelled her only credit card, which had initially been established under her late husband's social security number.
• The insensitivity encountered by a client when she informed her property casualty carrier of her husband's death to be chirpily told

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the company's representative, 'there goes your married couple's discount.'

One stress a survivor spouse may encounter is post-death estate tax planning. If the couple had a well-thought-out estate plan, their documents were likely structured to grant each spouse an opportunity for a $2.193 million exemption. How this occurs will depend upon how the documents were drafted. Typically, the estate planning document will state everything goes to the survivor spouse who then has a nine-month window in which to disclaim or relinquish their interest in certain assets. Following this, the assets are retitled into a trust (often referred to as a 'credit trust' or 'bypass trust') established for the survivor spouse's benefit.

To fund such a trust, it's essential to determine the value of the assets as of the date of the first spouse's passing. This involves obtaining appraisals for real estate and ascertaining the account balances or financial asset values of the first spouse's date of death. Using these valuations, the survivor spouse collaborates with their attorney, CPA, and often their financial advisor to best decide what should be disclaimed into the credit trust. Typically, the survivor spouse serves as the Trustee of the credit trust, which has its own tax identification number. The survivor spouse typically receives all income generated by the credit trust and, if needed, principal to maintain their lifestyle. Upon the survivor spouse's passing, the assets of the credit trust are not included in their taxable estate.

Another method to structure a credit trust is through specific language in the deceased spouse's Will or a revocable living trust, This language dictates that states upon the first spouse's passing, one-half of the community property and all

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the deceased spouse's separate property will be used to fund the credit trust. Here, it is still important to determine the value of the assets as of the first death as this determines the new cost basis. If the deceased spouse's assets are greater than $2.193 million, the credit trust will be limited to that amount, or the survivor spouse may opt to pay taxes on it to keep it out of their taxable estate.

An important note is that although the assets of the credit trust will not be included in the survivor spouse's taxable estate, the tax basis for the assets in the credit trust will be what the assets were worth upon the deceased spouse's date of death.

If you would like resources regarding what steps to take when a death occurs, or if you have questions regarding a special needs trusts or any other estate planning related topics, please contact our client care specialist, Margo Passeau, directly at (425) 296-3121 or by e-mail at margo@bethmcdaniel.com.

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