

RUBIN

LAW A Professional Corporation

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Our law practice is limited to "special needs legal and future planning" for our fellow Illinois families of individuals with special needs, including, but not limited to, intellectual disabilities, developmental disabilities, and/or mental illness.

(Attorney memberships include the Special Needs Alliance and the Academy of Special Needs Planners)

1st Party, Self Settled, Pay Back Special Needs Trusts (d4A)

A self-settled, d(4)(A), 1st party, pay back special needs trust will ordinarily be a grantor trust for Federal Income Tax purposes according to the IRS, with the Grantor being the beneficiary and not the trustor(s) or trust establishers.

1. §673. Reversionary interests. Section 673 causes grantor trust treatment of any trust in which the grantor "has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion." §673(c) adds: "...the value of the grantor's reversionary interest shall be determined by assuming the maximum exercise of discretion in favor of the grantor." In other words, the only way to avoid grantor trust treatment for a d(4)(A) trust will be to preclude the trustee from exercising discretion as to income or principal in excess of 5% of the value of the trust. That is why every d(4)(A) trust is a grantor trust, regardless of other provisions of the trust or the IRC.
2. §677. Income for benefit of grantor. If §673 doesn't get us to grantor trust status in every d(4)(A) case, §677(a) is going to do so. That section mandates grantor trust treatment any time ... income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be – (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; Clearly, §677 is going to mandate grantor trust treatment at least for every d(4)(A) trust in which the trustee is a non-adverse party.
3. EIN and 1041 requirements. Now that we know a d(4)(A) trust will be treated as a grantor trust, do we need to (a) secure a separate trust Employer Identification Number (EIN) and/or (b) file a Fiduciary Income Tax Return (Form 1041)? While it is permissible to secure an EIN for an irrevocable grantor trust, it is not required. Many practitioners (and trustees) report that the constant drumbeat from financial institutions, accountants and others insisting on an EIN, makes it easier to simply apply for the number. It may also help protect against identity theft to have a trust EIN. For the practical and determined trustee, however, using the grantor/beneficiary's Social Security Number is fine. Even if there is an EIN, the trust does not file a 1041 – except that it may (and probably should) file a simple return indicating that the trust's income is being taxed on the grantor's individual return. It is not an option to file a 1041 and take deductions on that form. It is of no significance if the trustee files a 1041 with "informational" data showing income and expenses passed through to the beneficiary (since the "information" has no recipient). There is no point putting any information on a grantor trust's 1041 other than the notice that no 1041 is being filed. It is an affirmative error to try to force any income tax effect onto the 1041.
4. Qualified Disability Trust? Can a d(4)(A) trust ever be a qualified disability trust? No. That is because it will always be a grantor trust, and the first requirement for a qualified disability trust is that it be a taxable entity.