

E. Termination of Third-Party Supplemental Needs Trusts – Typically, a third party supplemental needs trust will be drafted so that it terminates upon the primary beneficiary’s death. Usually, the primary beneficiary’s death will occur after the settlor’s death, but not always.

1. Income Tax

a. Settlor Dies Before Primary Beneficiary

(i) Grantor Trust – Grantor trust status terminates upon the death of the settlor and traditional fiduciary income tax rules for trusts apply.

(ii) Non-Grantor Trust – Continuation of traditional fiduciary income tax rules for trusts.

b. Primary Beneficiary Dies Before Settlor

(i) Grantor Trust – Grantor trust status continues until trust is terminated or the settlor dies.

(ii) Non-Grantor Trust – Continuation of traditional fiduciary income tax rules for trusts.

2. Gift Tax

a. Settlor Dies Before Primary Beneficiary

(i) Complete Gift – If there was a complete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences when the settlor dies (but, there may be estate tax consequences as to the settlor; very unlikely, however).

(ii) Incomplete Gift – If there was an incomplete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences to the settlor upon the settlor’s death (but, the trust assets will have to be included in the settlor’s gross estate for estate tax purposes and would receive a “stepped up” basis).

b. Primary Beneficiary Dies Before Settlor

(i) Complete Gift – If there was a complete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences to the settlor if the primary beneficiary predeceases the settlor. The trust will continue for the benefit of or terminate in favor of its remainder beneficiary or beneficiaries. Again, it may be possible for the trust assets to be included in the settlor’s gross estate for estate tax purposes, but the likelihood of this is very remote.