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Special Needs Planning: Insights & Updates March 2026 - Beyond Benefits: Integrating Tax Planning into Special Needs Planning

With April 15 approaching, taxes are top of mind for many people.

For families planning for a loved one with specific needs, tax considerations often take a back seat to the more immediate concern of protecting eligibility for public assistance benefits. That focus is understandable—but tax planning remains an important part of building a financial structure that will support a loved one with disabilities over the long term.

Well-intentioned gifts or inheritances can create unexpected tax consequences or complicate a financial structure designed to safeguard support systems. The most effective plans recognize and address the intersection of tax planning, estate planning, and public benefits planning.

When thinking about tax considerations in special needs planning, keep these key points in mind:

1. Special Needs Trusts and Compressed Tax Brackets

A third-party special needs trust, often considered the gold standard of planning for a loved one with disabilities, is typically treated as a separate taxpayer for income tax purposes. While this structure protects the beneficiary from having direct access to assets that could disqualify them from public benefits, it also creates a tax challenge: Trust income is taxed at highly compressed federal income tax brackets.

Unlike individuals who reach the top marginal tax bracket at relatively high income levels, trusts reach this top bracket once income exceeds a relatively modest threshold (roughly the mid-five-figure range under current law). As a result, even moderate trust income can be taxed at the highest federal rate. This makes investment selection and asset allocation within the trust particularly important and can significantly improve the after-tax longevity of trust assets, ultimately increasing the resources available to support the beneficiary over time.

2. Retirement Accounts Require Special Attention

Retirement accounts frequently represent a significant portion of a family's wealth and also can create complex planning issues when the intended beneficiary has special needs. The SECURE Act dramatically changed the rules governing inherited retirement accounts by requiring most beneficiaries to withdraw inherited funds within 10 years. However, an individual who qualifies as an Eligible Designated Beneficiary (EDB), including disabled beneficiaries, may still stretch distributions over their lifetime. This is a significant planning opportunity. When structured correctly, the trust can allow distributions to be calculated based on the disabled beneficiary's life expectancy (rather than being forced into the 10-year payout window).

This requires careful drafting. If the trust does not satisfy the applicable IRS requirements, several unintended and costly consequences may follow, such as:

- Retirement funds may be forced out of the account within 10 years, accelerating income taxes.
- Large mandatory withdrawals may push trust income into the highest tax bracket.
- Significant trust distributions can disrupt benefits eligibility.

Given the favorable distribution rules available to an EDB, thoughtful estate planning may allocate retirement assets—such as IRAs—to a special needs beneficiary who can stretch required distributions over their lifetime while directing non-retirement assets to other beneficiaries, thereby preserving tax deferral and maximizing the overall tax efficiency of the estate plan.

3. ABLE Accounts: A Complementary Tool

ABLE (Achieving a Better Life Experience) accounts have become a valuable addition to the special needs planning tool kit. These accounts allow certain individuals with disabilities to hold funds in a tax-advantaged savings account without immediately jeopardizing eligibility for means-tested benefits. From a tax perspective, ABLE accounts receive exceptionally favorable treatment.

Contributions to ABLE accounts are made with after-tax dollars, but earnings grow tax-deferred and qualified withdrawals (e.g., housing, education, transportation, assistive technology, and health-related costs) are completely income tax-free. In addition, the beneficiary may be able to make contributions from earned income under the “ABLE to Work” rules, and some states provide state income tax deductions or credits for contributions. When used properly, this structure allows funds to compound over time without the annual tax drag that often affects assets held in trust.

For many families, the most effective strategy is to pair a special needs trust with an ABLE account. The trust can provide long-term asset management and oversight while the ABLE account gives the beneficiary a flexible pool of funds for day-to-day needs.

This kind of coordination reflects a broader reality: Income tax planning, estate planning, and public benefits planning are deeply interconnected. Decisions about how assets are titled, how trusts are structured, and how distributions are made can all influence both tax efficiency and benefits eligibility.

Special needs planning is ultimately about more than tax rules or legal documents. It is about creating a sustainable financial structure that protects essential support systems while enhancing quality of life for a loved one with disabilities.

And as tax season reminds us each year, good planning doesn't just protect benefits—it helps ensure every dollar works harder for the person you care about most.

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