SEC. ___. AUTHORITY FOR PAYMENT OF DEATH GRATUITY TO TRUSTS.

Section 1477(a) of title 10, United States Code, is amended by adding at the end the following new paragraph:

"(3) In this subsection, the term 'person' includes—

"(A) the estate of the member; or

"(B) a trust legally established under any Federal, State, or territorial law, including a supplemental or special needs trust established under subparagraph (A) or (C) of section 1917(d)(4) of the Social Security Act (42 U.S.C. 1396p(d)(4)) for the sole benefit of a dependent child considered disabled under section 1614(a)(3) of that Act (42 U.S.C. 1382c(a)(3)) who is incapable of self-support because of mental or physical incapacity.".

[Please note: The "Changes to Existing Law" section below sets out in red-line format how the legislative text above would amend existing law.]

Section-by-Section Analysis

This proposal would allow military members to designate that, upon their death, the gratuity provided pursuant to section 1475 or 1476 of title 10, United States Code, be paid to a trust that is legally established under any Federal, State, or territorial law, to include a supplemental or special needs trust established for disabled children. The amount of the death gratuity has been increased on several occasions and is currently set at $100,000 pursuant to 10 U.S.C. 1478. Originally designed to meet the immediate needs of a service member's family following his or her death, the death gratuity, at its current level, frequently accounts for a sizeable portion of a service member's estate. Allowing payment of the death gratuity to a trust would provide greater planning capability for a service member to provide payments to those who require the protections of a trust, such as minor children or incapacitated adults.

There is currently no express statutory authority for a service member to designate a legal entity, such as a trust, as the beneficiary of his or her death gratuity. However, there are several reasons a service member might prefer to designate a legal entity, such as a trust, as the beneficiary of a death gratuity, rather than to designate a natural person. For example, service members often wish to name their minor children as beneficiaries of their death gratuity. In some instances, simply designating the gratuity for a surviving spouse is acceptable to the member. However, in other situations, such as where a service member has children and does not have a good relationship with the other parent, a service member might prefer to provide

directly for a child. When minor children are designated as the death gratuity beneficiary, it is possible that a person other than an individual designated by the member may receive the gratuity payment on behalf of the minor child. For instance, the gratuity may be disbursed into a custodial account for the child, where the custodian was not selected by the member and the minor will gain full control funds upon attaining the age of 18 or 21 years. Such a system does not allow the service member to designate a trustee where a trustee of the service member's choosing would manage the monetary asset during and even after the child's minority. Many estate planning professionals suggest that trusts or custodial accounts for minors should not terminate upon the age of majority, but rather at a time when it is anticipated the child will be mature enough to manage his or her own finances. Under this proposal, service members would have better planning capability to provide for their minor children in a manner that ensures responsible management of the death gratuity payment.

In addition to trusts for minors, trusts are often established for either incapacitated adults or adults who have simply proven incapable of managing significant amounts of money. In the case of incapacitated or special needs adults, trusts allow money to be used on behalf of the beneficiary while not diminishing Social Security disability payments as a result of personal assets. This proposal would allow the death gratuity to serve such individuals while not impacting eligibility for Social Security disability payments. Service members might also desire to name a trustee for a sibling or other adult that the service member finds incapable of handling a significant payment of money for reasons such as substance abuse or prior financial mismanagement. Under this proposal, service members could establish a supplemental or special needs trust for the benefit of the intended beneficiary, while naming a separate trustee to ensure the proceeds to the trust are utilized in a responsible manner.

Budget Implications: There are no resource requirements or proposed offsets associated with this proposal. This proposal would reduce the gift tax receipts going to the Treasury triggered by the transfer of death gratuities directly to trusts instead of first being given to intermediary custodians. The Treasury Department estimates the cost to be less than $1 million per year.

Changes to Existing Law: This proposal would make the following changes to section 1477 of title 10, United States Code:

§ 1477. Death Gratuity: eligible survivors.

(a) DESIGNATION OF RECIPIENTS.—(1) On and after July 1, 2008, or such earlier date as the Secretary of Defense may prescribe, a person covered by section 1475 or 1476 of this title may designate one or more persons to receive all or a portion of the amount payable under section 1478 of this title. The designation of a person to receive a portion of the amount shall indicate the percentage of the amount, to be specified only in 10 percent increments, that the designated person may receive. The balance of the death gratuity, if any, shall be paid in accordance with subsection (b).

(2) If a person covered by section 1475 or 1476 of this title has a spouse, but designates a person other than the spouse to receive all or a portion of the amount payable under section 1478 of this title, the Secretary concerned shall provide notice of the designation to the spouse.

<u>(3) In this subsection, the term "person" includes—</u>

(A) the estate of the member; or

(B) a trust legally established under any Federal, State, or territorial law, including a supplemental or special needs trust established under subparagraph (A) or (C) of section 1917(d)(4) of the Social Security Act (42 U.S.C. 1396p(d)(4)) for the sole benefit of a dependent child considered disabled under section 1614(a)(3) of that Act (42 U.S.C. 1382c(a)(3)) who is incapable of self-support because of mental or physical incapacity.

(b) DISTRIBUTION OF REMAINDER; DISTRIBUTION IN ABSENCE OF DESIGNATED RECIPIENT.—If a person covered by section 1475 or 1476 of this title does not make a designation under subsection (a) or designates only a portion of the amount payable under section 1478 of this title, the amount of the death gratuity not covered by a designation shall be paid as follows:

(1) To the surviving spouse of the person, if any.

(2) If there is no surviving spouse, to any surviving children (as prescribed by subsection (d)) of the person and the descendants of any deceased children by representation.

(3) If there is none of the above, to the surviving parents (as prescribed by subsection (c)) of the person or the survivor of them.

(4) If there is none of the above, to the duly-appointed executor or administrator of the estate of the person.

(5) If there is none of the above, to other next of kin of the person entitled under the laws of domicile of the person at the time of the person's death.

(c) TREATMENT OF PARENTS.—For purposes of subsection (b)(3), parents include fathers and mothers through adoption. However, only one father and one mother may be recognized in any case, and preference shall be given to those who exercised a parental relationship on the date, or most nearly before the date, on which the decedent entered a status described in section 1475 or 1476 of this title.

(d) TREATMENT OF CHILDREN.—Subsection (b)(2) applies, without regard to age or marital status, to—

(1) legitimate children;

(2) adopted children;

(3) stepchildren who were a part of the decedent's household at the time of his death;

(4) illegitimate children of a female decedent; and

(5) illegitimate children of a male decedent—

(A) who have been acknowledged in writing signed by the decedent;

(B) who have been judicially determined, before the decedent's death, to be his children;

(C) who have been otherwise proved, by evidence satisfactory to the Secretary of Veterans Affairs, to be children of the decedent; or

(D) to whose support the decedent had been judicially ordered to contribute.

(e) EFFECT OF DEATH BEFORE RECEIPT OF GRATUITY.—If a person entitled to all or a portion of a death gratuity under subsection (a) or (b) dies before the person receives the death gratuity, it shall be paid to the living survivor next in the order prescribed by subsection (b).