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SPECIAL NEEDS TRUSTS: WHEN AND HOW TO USE THEM

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SPECIAL NEEDS TRUSTS PROTECT ASSETS FOR SPECIAL PEOPLE

I. MORAL OF THIS PRESENTATION

If you are preparing an estate plan for a client with a loved-one who has special needs, you need to consider drafting a third party special needs trust into the estate plan to benefit that person. If you are dealing with a special needs client or beneficiary who is scheduled to receive an unplanned (or defective) inheritance or settlement from a lawsuit, and that person is otherwise eligible (or may become eligible) to receive public assistance benefits, you need to seriously consider having those payments paid into a first party special needs trust.

So,

II. WHAT IS A SPECIAL NEEDS TRUST (SOMETIMES ALSO CALLED SUPPLEMENTAL NEEDS TRUST)?

- A. A special needs trust (“SNT”) is a trust used primarily to preserve public assistance benefits for the beneficiary of the trust.
1. Assets in the trust are not counted as “resources” of the “disabled” beneficiary which would render him/her ineligible for public assistance benefits;
 2. Trustee makes distributions in such a way as not to affect the disabled beneficiary’s eligibility for public benefits; and
 3. Assets from the SNT are then available to supplement the care and/or services that are not provided by public assistance programs.

Examples of public assistance benefits to be protected are SSI, SSA, **Medicaid**, HUD/Section 8 housing allowances, and a plethora of state (and sometimes local) assistance programs.

B. Kinds of Special Needs Trusts

1. Third Party Special Needs Trusts (usually created by relatives' estate plans):
 - a. Common law special needs trust;
 - b. Sole benefit trust;
 - c. Wholly discretionary trust; or
 - d. A specific State sanctioned trust.
2. First Party (sometimes called self-settled) Special Needs Trusts.
 - a. (d)(4)(A) Medicaid Payback Trust.
 - b. (d)(4)(B) "Miller Trust."
 - c. (d)(4)(C) Pooled Trust.

These trusts (which are reviewed in more detail below) all share the following characteristics:

- d. Trust assets are not counted as available resources for public assistance qualification (really disqualification) purposes;
- e. Transfers to these trusts are not subject to transfer penalties; and
- f. Interest or dividend income generated by the investments of these trusts are not counted as income for purposes of public benefit eligibility – with limited exceptions.

C. How is "disabled" defined for determining whether someone is eligible for public assistance?

1. A person is disabled if he/she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to last for a continuous period of not less than twelve months or end in death. A person is not necessarily

disabled for SSI or Medicaid purposes if a guardian has been appointed, but that can be a significant factor.

2. Types of people who are disabled, according to 42 U.S.C. §1382c:

- a. Elderly people who have become infirm;
- b. Nursing home residents;
- c. ALF residents;
- d. Minor children with disabilities;
- e. People with disabilities living in the community;
- f. Disabled recipients of, or applicants to, government assistance programs, such as Medicaid or SSI;
- g. Recipients of personal injury settlements or judgments who need to apply for, or protect their continuing eligibility for, public assistance benefits.

3. Determinants of disability:

- a. Diagnosis?
- b. Life expectancy?
- c. Has person been declared “disabled” by State’s appropriate court?
- d. Is disability permanent?
- e. If the person is not disabled, is he/she likely to become so?
- f. Is the person receiving public benefits at present? If so:
 - i. Is the person receiving SSI (usually results in automatic Medicaid eligibility)? These are “means-tested” public benefits, meaning person cannot have too much income or resources (discussed below).

- ii. SSA/SSDI (results in Medicare eligibility). No asset or unearned income restrictions.

Always request written verification of the person's benefits. Often they don't really understand which benefits they are receiving.

D. What is the source of funds for the special needs trust?

- 1. Parents' (or others') money (this is "third party" money)?

A trust that is properly planned by another prior to death or gift.

- 2. Disabled beneficiary's money (this is "first party" money)?

- a. Lawsuit/settlement benefiting a disabled beneficiary;
- b. Unplanned inheritance benefiting a disabled beneficiary;
- c. Defective trust that would result in disqualification of benefits.

E. Are the assets of the special needs trust a countable resource which will disqualify the person from receiving public benefits (usually Medicaid or SSI)?

Federal Law governs: OBRA '93 -- 42 U.S.C §1396p(d)

- 1. Revocable trust assets are a countable resource (*i.e.* to the parent) until the parent dies. If parent has a revocable living trust (say to avoid probate, to do tax planning, or both) which becomes a special needs trust for the child at parent's death, the SNT assets are NOT a countable resource.

If properly structured, this would be a third party SNT that would NOT require a repayment to the State upon the disabled child's death (see 2, next).

- 2. A third party special needs trust is one created by someone else (like a parent or other relative or friend) for the benefit of the special needs person. Can be created before the donor's death (watch out for potential gift tax consequences) or at the donor's death (which is more typical).

- a. Can be created by a Will (“testamentary”) or during lifetime (“*inter vivos*”);
 - b. May benefit others besides the disabled beneficiary (sometimes called a “discretionary” or “pot” trust) This may not be advisable in about half the states in the U.S. (e.g. Ohio), so check with counsel in the state where the beneficiary will receive public assistance benefits;
 - c. At the disabled beneficiary’s death it pays to the beneficiaries (“remaindermen” or “remainder beneficiaries”) the grantor selects. The State is NOT required to be repaid anything;
 - d. The trust is governed by state law.
3. The “(d)(4)(a)” (referring to 42 U.S.C. §1396p(d)(4)(a)) “payback” (or “first party” or “self-settled”) special needs trust:
- a. Created with the beneficiary’s own resources -- either from a lawsuit settlement or judgment, or from an inheritance where a third party SNT was not created;
 - b. The **disabled person must be sixty-five or under** when created and the trust is funded;
 - c. Must be established at the request of the parent, grandparent, guardian (sometimes called a conservator) or a court;
 - d. Can only benefit the disabled person during the beneficiary’s lifetime;
 - e. State must be repaid ALL medical assistance (*i.e.* Medicaid) benefits that were paid on behalf of the disabled beneficiary upon his/her death, **TO THE EXTENT** assets are then left in the SNT. Supplemental Security Income (SSI) payments are not required to be repaid.
 - f. Prohibited payments at disabled person’s death, before payback to State:

- i. Debts owed to third parties;
- ii. Funeral expenses -- unless they had been prepaid;
- iii. Administration expenses and taxes, except reasonable fees for administration of the trust estate such as an accounting of the trust to a court, completion and filing of documents, or other required actions associated with the termination and wrapping up of the trust, and taxes due from the trust to the state(s) or federal government arising because of the beneficiary's death (POMS Section SI 01120.203(3)(a)); and
- iv. Payments to residual beneficiaries.

i.e. the State gets paid-back first!

4. The "(d)(4)(b) (referring to 42 U.S.C. §1396p(d)(4)(b)) "Miller Trust" (also sometimes referred to as a Qualified Income Trust, or "QIT"). These trusts serve a very limited purpose – basically to solve income problems related to long term nursing home benefits for primarily the elderly.¹

¹ The Deficit Reduction Act of 2005 ("DRA") had a significant effect on Medicaid planning – particularly for the elderly:

1. The look back period for all transfers below fair market value is now sixty months for irrevocable trusts. Penalties now begin at the date of application for government assistance for individuals who transfer assets at less than fair market value;
2. There is no longer a rounding down for monthly gifting, and all transfers are grouped together. Transfers and gifting are not considered to be "for the sole benefit" and are, therefore, disallowed;
3. Annuities may no longer include balloon payments, and, in most cases, the State must be named as the contingent beneficiary at the death of the beneficiary to the extent necessary to pay back government liens;
4. Personal service contracts are limited and narrowly defined in some states, but can be used with SNTs as well as pooled ((C)) trusts;
5. Home equity over \$500,000-\$750,000 (for married couples where there is a "community spouse" living in the home) is now a countable asset; and
6. Purchase of a life estate is permissible, but only if the beneficiary is living at that home and not in an assisted living facility or nursing home.

- a. The trust can only receive and hold income;
 - b. Except for a small personal needs allowance (\$35.00 per month), all income received each month must be spent for the beneficiary's care;
 - c. Any funds remaining in a Miller Trust at the beneficiary's death must be used to reimburse the State for all medical benefits provided during the beneficiary's lifetime (just like the (d)(4)(a) trust).
5. The "(d)(4)(c)" (referring to 42 U.S.C. §1396p(d)(4)(c)) Pooled Account or Pooled (or Master) Trust.
- a. Established and managed by a non-profit association (like the ARC in many states). (In Kentucky, The Kentucky Pooled Trust (into which the Cedar Lake Foundation pooled trust, the only other pooled trust in Kentucky) has been merged);
 - b. Funded by the disabled person or someone on his/her behalf (with the disabled person's inherited funds or funds received in a legal action);
 - c. State must be repaid ALL medical assistance (*i.e.* Medicaid) benefits that were paid on behalf of the disabled beneficiary from beneficiary's account upon his/her death, TO THE EXTENT assets are then left in his/her account (*i.e.* of the pooled trust); **or, the money may stay in the pooled trust** (which is a nonprofit entity) **to benefit other nonprofit organizations that serve special needs people.**
 - d. Many disabled people can contribute to the fund, so benefits those with small to midsize estates or small families (*e.g.* where no family member is available to administer a SNT or funds are too small to justify trust company (bank) management) just for the individual; and there is
 - e. **No age limit on participation.**

- F. What is the interplay between a special needs trust and the receipt of (or disqualification from) public assistance benefits?
1. Improper administration of even a well prepared SNT can reduce, limit or terminate a disabled beneficiary's public benefits. Seek advice of competent counsel. Also consider purchasing a copy of Jackins, Barbara, et. al, Special Needs Trust Administration Manual (a Guide for Trustees), iUniverse (2005).
 2. Trustee must understand SSI and Medical Assistance (*i.e.* Medicaid) rules. Again, seek advice of competent counsel or consider purchasing a copy of Elias, Stephen, Special Needs Trusts (Protect Your Child's Financial Future), Nolo (2005).
 3. Some of the payment rules and options are discussed next.

III. HOW CAN TRUST FUNDS BE (OR NOT BE) USED?²

A. Overview

1. Monthly SSI payments can be reduced if the trustee gives the beneficiary cash or pays for the beneficiary's food or shelter ("ISM").
2. SSI Benefits can be lost for any month in which the beneficiary receives too much cash or owns too much in the way of "countable" assets. A beneficiary who no longer qualifies for SSI will automatically lose eligibility for Medicaid (until SSI is restored).

B. Resource Limits for SSI Qualification

1. More than \$2,000 (\$3,000 for a married couple) of **"countable" resources**.
 - a. Examples of countable resources:
 - i. Bank accounts;
 - ii. Stocks and bonds;
 - iii. Real estate -- other than a home.

² Derived largely from information found in Chapter 3 of Elias, *supra*.

- b. Examples of noncountable resources:
 - i. The disabled beneficiary's home (including land);
 - ii. Necessary car or van;
 - iii. Furnishings and personal effects;
 - iv. Burial and life insurance with a face value up to \$1,500.

2. **Income limits:** If countable income in any month exceeds the SSI benefit, SSI (and thus Medicaid qualification) can be lost for that month. These calculations can be very confusing, but are extremely important. To see how this might work, go to:

www.socialsecurity.gov/notices/supplemental-security-income/text-income-ussi.htm.

- a. Earned income: If beneficiary **earns** more than \$65.00 p/month, SSI will be reduced by the equation (see website).
- b. Unearned income (cash or assets that can be easily converted to cash) from gifts, donations, prizes, interest from bank accounts, dividends, etc. *E.g.* Money given by trustee of SNT to beneficiary is unearned income in the month received. (Any of it left in a subsequent month would be part of the countable resources.)
 - i. First \$20.00 of unearned income has no effect of SSI;
 - ii. Amounts over that reduce the SSI grant dollar-for-dollar.
- c. In-kind income is food or shelter (including payments for rent or mortgage, utilities, etc.) (in-kind gifts of other items are not in-kind income). **In-kind income reduces the SSI grant up to the lesser of:**

- i. **the value of the gift, or**
- ii. **1/3 of the maximum federal portion of the SSI grant less \$20.** For 2010 that amount is \$674. (The max. federal SSI grant increases each year, with the cost of living. To compute max. reduction in any year, take 1/3 of the maximum allowable payment, deduct \$20 from it, and that is the max. reduction in any month; so the net monthly benefit will still be \$449.44. (See, e.g. www.ssa.gov. In 2010 the maximum reduction is \$224.66 per month.) There is a state supplement available to the federal SSI grant in some states, but not Kentucky.

Key planning matter for Trustee of SNT: Trustee may choose to provide in-kind income to beneficiary (in order to increase lifestyle, standard of living, etc.) while only reducing the SSI grant by the monthly amount. May be a good trade-off, as determined by Trustee, in its discretion. **Be careful, however, if reduction wipes out all SSI, automatic Medicaid may also be lost and beneficiary may have to apply for a special waiver. Contrarily, in most states, if disabled beneficiary receives at least \$1 of SSI, she/he automatically qualifies for Medicaid.**

- d. Elias, *supra*, lists the following items as examples of things that **can** be paid for by the trustee of the SNT:
 - i. Out-of pocket medical and dental expenses;
 - ii. Home improvements;
 - iii. Medical equipment not provided by Medicaid;
 - iv. Computers, etc;
 - v. Eyeglasses;
 - vi. Cable TV;
 - vii. Exercise equipment;
 - viii. Telephones, TVs, radios;
 - ix. Annual independent checkups;
 - x. Cameras;
 - xi. Transportation;
 - xii. Trips and vacations;
 - xiii. Motor vehicles;
 - xiv. Visits to friends;

- xv. Vehicle maintenance;
- xvi. Entertainment;
- xvii. Vehicle insurance premiums;
- xviii. Life insurance premiums;
- xix. Newspaper & magazines;
- xx. Physical rehab services;
- xxi. Athletic training & comp;
- xxii. Essential dietary needs;
- xxiii. Personal care attendants;
- xxiv. Materials for hobbies;
- xxv. Voc. rehab. or hab;
- xxvi. Tickets for rec. & cultural events;
- xxvii. Professional services;
- xxviii. Musical instruments;
- xxix. Tuition & related exps;
- xxx. Costs related to attending meetings;
- xxxi. Cosmetics;
- xxxii. Memberships in book, health, etc. clubs;
- xxxiii. Conferences & seminars.

Elias, p. 34.

Key is for trustee to make payments directly to providers and not to the beneficiary or in reimbursement to the beneficiary.

IV. WHO MAY SERVE AS TRUSTEE OF A SPECIAL NEEDS TRUST?

- A. An individual other than the beneficiary, age eighteen or older.
 - 1. Advantages of using an individual Trustee:
 - a. A feeling of more individual (family or friends) control over trust's assets and administration;
 - b. A feeling of controlling costs and expenses.
 - 2. Disadvantages:
 - a. Demands a great deal of time and attention;
 - b. Requires acute accounting and the preparation of income tax returns (which can be delegated);
 - c. Managing a trust requires fiduciary knowledge, skill and diligence. Any individual undertaking this respon-

sibility must not only have the willingness to serve, but undertake the necessary education to serve as a fiduciary;

- d. Public assistance rules are excruciatingly complex, and constantly changing. It is nearly impossible for anyone not working continuously in the area to become and remain well-versed in the intricacies of the law, and to be able to navigate the administrative maze that is often involved; and
- e. Increased risk of loss to the trust/beneficiary (without ability for adequate indemnification).

B. A professional (corporate) Trustee

1. Advantages:

- a. It is what they do. They are able to skillfully handle all of the areas that are disadvantages for the individual trustee.
- b. They have experience which can help provide additional resources for helping the SNT beneficiary enhance or increase the level of care and services they receive.
- c. They can reduce the potential liability in the decision-making process related to the settlement allocation (such as helping with Medicare/Medicaid lien resolution and set-asides discussed in much more detail elsewhere in this seminar).
- d. They are bonded (should be confirmed by the planner).

2. Disadvantages:

- a. There is a cost associated with this professional service; and
- b. There may be a perceived loss of input by family and/or friends (which can be addressed through advisory and other roles).

V. CONCLUSION

SSI and Medicaid (**in particular Medicaid, because of the cost of health care**) processes are a real hassle, but well worth it. Creating a special needs trust is the federally mandated way to protect those benefits and to maintain the disabled beneficiary's assets for other needs and lifestyle enhancements.

