Special Needs Trusts – peace of mind for loved ones and family members

By Grant S. Snell

Special Needs Trusts ("SNTs") are trusts designed to provide assets for the care and comfort of beneficiaries who are disabled without jeopardizing their access to various means-tested government programs and benefits. The cost of care for disabled individuals can be prohibitive, and most families cannot afford such costs privately. In many cases, government-funded programs are the only available programs for persons with disabilities, making access to these services critical. However, the requirements for qualifying for these benefits often prevent families from providing additional support to their disabled loved ones to increase their quality of life.

GOVERNMENT BENEFIT PROGRAMS - BASICS

Planning using SNTs for beneficiaries who are disabled requires a basic understanding of how government benefits systems work and the eligibility requirements for the various programs. While SNTs are used primarily to assist disabled individuals achieve and maintain eligibility for "means-based" programs, it is important to understand how other government programs interrelate and in some cases complement the means-based programs.

To qualify for government benefits, an individual must be considered "disabled" according to Social Security Administration ("SSA") criteria. SSA defines a "disabled" person as one who is over the age of 65, blind, or unable to do any substantial gainful activity due to physical or mental impairments that will result in death or will continue for not less than one year.[1] "Substantial gainful activity" is the ability to do work that produces earnings.[2] "Physical or mental impairments" are disabilities that appear on the Social Security Administration Listing of Impairments.[3]

Once a disability is established, the types of benefits available will depend on additional criteria. Some benefits, such as Social Security Disability Income (SSDI), are based on the earnings record of the worker prior to disability or retirement.[4] Some benefits are entitlements, such as Medicare, which is available to all people who have attained age 65 or those with specific disabilities.[5] The "means-based" programs, such as Supplemental Security Income (SSI) and Medicaid, evaluate the current income and resources of the disabled person to establish eligibility. In order to access these means-based benefits, the recipient must not only be aged, sick, and/or unable to work, but also have limited income and resources.

Government benefits for persons who are disabled include both cash payments and health care. SSI and SSDI provide cash for those who are eligible. For many disabled people, this is the only income that they receive because they are too sick, too weak, or too old to have another source of income. The major government health care programs are Medicare and Medicaid. Medicare provides coverage for acute care, such as doctors visits, hospitalization, and some rehabilitation, but it does not cover the cost of long-term custodial care. Medicare recipients may also have access to private health insurance, which supplement Medicare to provide coverage of medical services not provided by Medicare. However, most health insurance policies will not cover long-term custodial care. Long-term care insurance will pay for custodial care, but it is not available for someone who is already disabled. Medicaid is the only government program in the United States that provides for long-term skilled nursing care for persons with disabilities other than the Veterans Administration. Medicaid, a joint federal and state government program, pays for prescriptions, therapy, and doctor visits as well as custodial care for those meeting the medical and financial eligibility requirements.

MEANS-TESTED PROGRAMS – ELIGIBILITY REQUIREMENTS

In most states, including Montana, eligibility for SSI categorically results in Medicaid eligibility, even though the benefits provided under the two programs are quite distinct. Briefly, in order to maintain eligibility for SSI, a recipient cannot receive income in excess of $710.00 per month (some

1 42 U.S.C. § 423(d)(1)(A).
2 42 U.S.C. § 423(d)(4)(A).
3 http://www.ssa.gov/disability/professionals/bluebook/AdultListings.htm
4 http://www.ssa.gov/dibplan/index.htm
5 http://www.medicare.gov

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exceptions apply).[6] SSI rules consider an individual's earned income, unearned income, in-kind income, and deemed income (with some exceptions explained below) during a particular month as "income" in applying the eligibility test. At the end of the month, income that is not otherwise spent converts to a resource. Thus, a resource is any accumulated income, bank accounts, retirement accounts, or basically any asset that could be converted to cash (with some exceptions explained below). An SSI recipient may not own resources that are available to be spent on food and shelter in excess of $2,000.00.[7] Income and resources are measured independently.

It is important to note that debts and liabilities do not offset resources unless the debt is legally secured by the specific asset, such as a home mortgage or secured vehicle loan. Even if an individual has thousands of dollars in medical debt outstanding, if he or she has more than $2,000 in countable resources, he or she will not qualify for SSI or Medicaid. This is a common misconception and can result in unnecessary periods of ineligibly for applicants for benefits while their applications are processed and they are unaware they are over-resourced. Eligibility will not be applied retroactively even though the individual could have easily been eligible by paying down outstanding debts with resources over the eligibility limits.

Some income and some resources are exempt from the eligibility calculations. Exempt income includes other means-based payments such as food stamps, medical care and services, income tax refunds, loans, and any item that if retained would not be a countable resource.[8] Exempt resources include: the personal residence of the recipient (there may be an equity limitation depending on the circumstances); one vehicle, if it is needed to provide transportation; personal property; life insurance with a face value of less than $1,500; irrevocable burial plans; and SNTs.[9]

The eligibility criteria referenced above apply to all individuals applying for SSI and single persons applying only for Medicaid (without SSI). Married persons applying for Medicaid to pay for skilled in-home or custodial nursing care (the "Institutionalized Spouse") have a different set of eligibility rules designed to prevent impoverishment of the spouse who is not applying for Medicaid (the "Community Spouse"). Medicaid evaluates the income and resources of both spouses to determine eligibility.

The Community Spouse may be able to retain some or all of the Institutionalized Spouse's income depending upon the Community Spouse's own income and basic shelter expenses.[10] The rest of the Institutionalized Spouse's income will be used to pay the skilled-nursing care facility, less a personal needs allowance of $50.[11] The Community Spouse retains all of their individual income.[12]

Instead of the $2,000 resource limit that applies to single persons, married couples may retain half of their combined countable resources (excluding the same exempt resources listed above), subject to a maximum of $117,240 and a minimum of $23,448.[13] Once the Institutionalized Spouse starts receiving skilled-nursing care, the couple must generally "spend down" resources to reach the resource level that Medicaid determines before Medicaid will start providing benefits. A full discussion of the various spend down strategies and asset transfer rules is beyond the scope of this article, but the transfer of assets to a specific type of SNT, a Pooled Trust (discussed below), is now an available option for those over 64 years old seeking Medicaid eligibility to pay for skilled-nursing care.

SPECIAL NEEDS TRUSTS

SNTs are considered exempt resources for means-based government programs. A properly drafted SNT will preserve assets for the benefit of a disabled person, allowing that person to experience a better quality of life than that afforded by government benefits alone. SNT funds can be used to supplement, but not supplant, government benefits by providing recreation and entertainment, rehabilitative and vocation training, transportation, personal care, personal supplies, and dental and medical care not otherwise provided by government programs for the disabled individual.

The SNT document will be reviewed by the Social Security Administration and/or Medicaid for compliance with all the government benefit and state laws and regulations.[14] In order to be compliant, a SNT must meet the following basic criteria: a SNT must be written and its terms express; the SNT must be irrevocable; the beneficiary cannot be the trustee or have any type of control over distributions; all distributions of income and/or principal must be in the discretion of the trustee; the Trustee should expressly be prohibited from making any distribution that would jeopardize the recipient's government benefits (with some special exceptions).

Even though a SNT must be irrevocable, careful drafting can provide flexibility within the trust document to allow for changed circumstances or changes in the law. The terms of the trust should always allow the trustee to reform the trust to protect eligibility for benefits.

The individual who is disabled must be the sole beneficiary of the trust during his or her lifetime. However, the SNT can provide compensation for caregivers and pay for the cost of travel for a caregiver to accompany the individual with disabilities, even if the caregiver is a family member.

There are two basic types of SNTs. Self Settled, or first-party, SNTs are established with the disabled individual's own assets. Third Party SNTs are established with assets of other persons for the benefit of the disabled individual. Each trust functions identically with the same distribution restrictions, but there are some key differences.

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6 http://www.ssa.gov/ssi/text-income-ussi.htm
7 http://www.ssa.gov/ssi/text-resources-ussi.htm
8 http://www.ssa.gov/ssi/text-eligibility-ussi.htm
9 Ibid.
10 Montana ABD Medicaid Manual ("MA") – 904-1, 2, 3
11 Ibid.
12 Ibid.
13 MA 005
14 42 U.S.C. § 1396p; POMS (https://secure.ssa.gov/apps10/poms.nsf/partlist) – SI 01120.200, .201, and .203; §72-38-101, et. seq. (Montana Uniform Trust Code); and MA 402-3

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Self-Settled SNTs

Assets held in a typical inter-vivos trust for the benefit of a disabled individual are countable assets for means based public benefits.[15] Also, disabled individuals may be assessed a "penalty period" for transfers of assets to other persons or to certain irrevocable trusts unless the transfers occurred more than five (5) years before the individual was otherwise eligible for public benefits.[16] This "penalty period" can put the applicant in the worst possible situation, i.e., not having the assets to pay for care, but being penalized as if the applicant has the assets, and therefore being unable to obtain needed benefits. Transferring one's own assets to a trust as a planning method five (5) years in advance of need is feasible only in very limited situations.

However, by enacting 42 U.S.C. § 1396p (d)(4), Congress created two types of safe harbor trusts that can resolve this dilemma for Medicaid eligibility. Thus, not only are these First Party SNTs treated as exempt resources, the transfer of the disabled person's assets to these statutory self-settled trusts are exempt from the penalty period.

The first type of trust is provided for is found in 42 U.S.C. § 1396p (d)(4)(A) and is commonly called a "d4A" trust or "First Party SNT". Because the d4A trust is funded with the beneficiary's own assets, the statute requires that at the death of the beneficiary or termination of the trust, the remaining assets in the trust must be used initially to reimburse any state government that provided Medicaid to the beneficiary during his or her lifetime. Therefore, this trust can also be called a "payback trust." In addition to the payback requirement, the d4A trust may be created only by a parent, grandparent, court, or guardian; and the disabled beneficiary must be younger than age 65. Further, funds cannot be put into the trust after age 65. The trust must provide that Medicaid will receive all amounts remaining in the trust upon the death of the disabled individual up to the total amount of medical assistance paid on behalf of the individual during his or her lifetime. Remaining trust assets after the Medicaid payback can be distributed to the chosen remainder beneficiaries, but only very large trusts will likely have remaining assets after Medicaid payback.

The second type of safe harbor for a self-settled trust is found in 42 U.S.C. § 1396p (d)(4)(C) and is commonly called a "Pooled Trust". A Pooled Trust is established and managed by a nonprofit association (in Montana, the "Self Sufficiency Trust" established and managed by PLUK – "Parents, Let's Unite for Kids," in Billings, Montana is the only certified Pooled Trust in Montana). The Pooled Trust can contain assets of the beneficiary or third parties and must require Medicaid payback upon the beneficiary's death similar to a First Party SNT. In addition to the Medicaid payback, 10% of any remaining funds on the beneficiary's death must be donated to a charitable trust to be used by the Montana Department of Public Health and Human Services for the purpose of providing for the care and treatment of low-income persons with disabilities. Pooled trusts are administered by a "trust advisor," chosen by the trust's donor, in accordance with a Life Care Plan for the beneficiary, which is prepared and reviewed in connection with an advisory board consisting of state employees, persons associated with the non-profit, and persons in the community familiar with issues facing disabled individuals. Pooled trusts can be more efficient to establish and administer than a First Party SNT because the funds are pooled and managed collectively with those of other Pooled Trust beneficiaries and because the Life Care Plan and trust advisory board act as a guide to the trust advisor. However, the process of accessing funds in a Pooled Trust can be cumbersome making Pooled Trusts less flexible than a First Party or Third Party SNT.

Pooled Trusts can be created for disabled individuals of any age. Montana has just recently lifted the former rule, which assessed an asset transfer penalty for transfers to Pooled Trusts for disabled individuals aged 65 and older.[17] Pooled Trusts have now become a viable planning option for those needing Medicaid to pay for long-term custodial care. Persons can accomplish the required "spend down" by establishing a Pooled Trust and transferring the required amount of assets to the trust. Trust assets can be used to pay for the single room differential in a skilled nursing facility (Medicaid only pays for a double room), for entertainment, such as cable TV, for clothing, for additional therapy, for beautician services, etc.

Third Party Trusts

Third Party SNTs are typically established by a disabled individual's family members. This can be done in either a living (or "inter-vivos") trust or a testamentary trust, which is established in a will. Third Party SNTs do not require a Medicaid payback, so the trust can provide that the remaining trust assets be distributed to the chosen remainder beneficiaries of the grantor at the death of the primary disabled beneficiary.

It is vitally important that family members of disabled individuals understand that by receiving an inheritance the disabled individual will likely become disqualified from means-tested government benefits until the inheritance is spent on that person's care. To avoid this problem, families have historically either disinherited the disabled individual, which leaves an already vulnerable individual even more dependent upon uncertain government benefits, or left the inheritance to another family member with an "understanding" that the funds are to be used for the disabled individual's benefit. The "understanding" option leaves those funds exposed to several risks as the funds may never be used as intended and the funds will be subject to the other family member's creditors, divorces, etc. The disabled individual receiving the inheritance could always establish a Self Settled SNT to hold those funds and allow them to re-qualify for benefits; however, Self-Settled

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15 POMS – SI 01120.200; MA 402-3

16 POMS – SI 01150.110; MA 404-5

17 Montana DPHHS will not apply the penalty period even though MA404-1 still contemplates the penalty.

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SNTs require Medicaid payback. A better option is for family members to establish either an inter-vivos or testamentary Third Party SNT, so they may direct where any remaining funds will go upon the death of the disabled beneficiary.

The Trustee

Trustees of SNTs have the same duties as trustees of other trusts. These duties include the duty of loyalty, the duty of care of a prudent person, the duty to observe the terms of the trust agreement, and the duty not to waste or squander the trust assets.[18] However, trustees of a SNT have added responsibilities.

A trustee of a SNT must develop a working knowledge of the government benefits for which the beneficiary is qualified, because the trustee must understand which distributions are appropriate and which are not. This can mean not making certain distributions, such as cash, food or shelter expenses to an SSI beneficiary. A SNT trustee must know the long-term care plan for the beneficiary, his or her life expectancy, and what activities are possible or are reasonable for the beneficiary. A trustee of a SNT should be creative in anticipating activities or items that will enhance the beneficiary's life. For example, a beneficiary who is totally physically disabled, and who requires 24-hour care in a nursing home, but who is not totally mentally disabled, might enjoy a vacation or an outing to a movie or play. The cost of such a trip may include the cost of a personal companion.

A SNT trustee must understand which distributions would jeopardize means-tested benefits . For example, if an SSI beneficiary receives cash payments that are deemed to be for the recipient's food and shelter, such payment is treated as "in-kind support and maintenance," andreduces SSI benefits. Therefore, the trustee should not pay the beneficiary's rent or buy groceries for the beneficiary, because those are in kind payments for shelter and food. Under some circumstances, it is in the beneficiary's best interests for distributions to be made that will reduce SSI, but this must be done with careful consideration and in accordance with the terms of the SNT.

The SSI and Medicaid programs require periodic reporting for all recipients. Eligibility will be denied if the reports are not complete. The existence of the SNT must be reported. Additionally, if the beneficiary changes address, gets married, obtains more resources or more income, or improves in medical condition, these changes must be reported. The report is due within ten (10) days of the end of the month in which the change occurred.

The trustee must respond promptly to any notices received from the SSA or from Medicaid. If notice is given of a change in benefits that is detrimental to the beneficiary, the beneficiary has sixty (60) days in which to file a written notice of an appeal in order to keep the benefits in place during the appeal process. The trustee cannot ignore or postpone dealing with any government agency.

As with many types of trusts, a co-trustee of a SNT may be advisable if the trust holds significant assets, a corporate trustee may be beneficial for long-term investment expertise. However, an appropriate family member can be a co-trustee in order to monitor the day-to-day needs of the beneficiary. Trustees of SNTs often need ongoing legal representation. To the extent possible, the trustee should stay abreast of changes in the law. Generally, an annual review meeting with the trustee and counsel is recommended.

18 §72-38-801, et. seq.

PROFESSIONALS MUST RECOGNIZE NEED FOR SPECIAL NEEDS TRUSTS

Special needs planning is a dynamic area of law that should be undertaken only by those with specialized training. However, just having the ability to recognize the need in a given situation to preserve someone's public benefits and referring them to an appropriate advisor can prevent some devastating professional consequences. Personal injury attorneys, estate planners, and general practitioners should take heed to the following malpractice cases resulting from the professional's failure to preserve public benefits.

Personal Injury Cases

1. *Christina Grillo settled a personal injury case in 1991 for a lump sum upon the advice of her personal injury attorney. She later sued the attorney and guardian ad litem for malpractice. She alleged that the defendants: (1) failed to consult competent experts concerning a structured settlement and (2) failed to plan to preserve her SSI and Medicaid eligibility. Ms. Grillo alleged that structured settlement with a d(4)(A) SNT would have protected her personal injury settlement from dissipation, provided tax benefits, and protected her SSI and Medicaid benefits. The case was settled by all defendants for a combined sum of $4.1 million.*[19]

2. *Edith Saunders, the conservator for James A. Saunders III (Jamie), settled a personal injury action on Jamie's behalf. As a part of the application to compromise and settle the claim, the conservator requested that the net settlement amount be placed in a d(4)(A) SNT for Jamie to preserve his Medicaid eligibility. The State of Connecticut objected. The Supreme Court of Connecticut rejected the attorney general's argument that the*

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conservator should spend down all of Jamie's

19 *Grillo v. Petiete et al.*, 96-145090-92, 96th Dist. Ct., Tarrant Cty., Texas, and *Grillo v. Henry Cause*, 96-167943-96, 96th Dist. Ct., Tarrant Cty., Texas. See also *French v. Glorioso*, 94 S.W.3d 739 (Tex. T. App. 2002) which demonstrates the potential for malpractice liability for failure to advise clients about the impact of a settlement on public benefits eligibility.

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> *assets and then re-apply for Medicaid assistance. The court ruled: "By contrast, with the creation of the trust, Jamie will retain his Medicaid eligibility and Saunders (the conservatrix) can provide for his supplemental needs from the trust assets, while Medicaid provides for his basic medical care. Therefore, not only is the latter course of action clearly better for Jamie, it may be fairly stated by failing to follow it, the probate court, and Saunders could be deemed to be in dereliction of their duties to James (italics added)."*[20] *This duty requires the fiduciary of an estate and indirectly, the trial lawyer, to protect the client's settlement.*

A trial attorney has the duty to ensure his client is informed about the options of structured settlements, trusts and the effect of the judgment of settlement on the client's public benefits eligibility.[21]

Estate Planning Case

1. *In 2000, an attorney was retained to draft a will that left a significant sum to the testatrix's' sister who resided in a nursing home. The Medicaid program was paying for the sister's care. After the testatrix's death, the sister was disqualified for Medicaid assistance, had to spend down the inheritance and reapply for Medicaid assistance. The Supreme Judicial Court of Maine held that the attorney "... could and should have drafted a 'Supplemental Needs Trust' [Third Party SNT] for... [the testatrix's sister], thereby avoiding the Medicaid spend down..." On October 25, 2002, the court suspended the drafting attorney's license to practice law because of his failure to create the special needs trust and for other reasons.*[22]

CONCLUSION

People with disabilities rely heavily, and sometimes exclusively, on means-tested government benefits for their basic needs. With the average yearly cost of skilled-nursing care in Montana exceeding $73,000[23], Medicaid is often the only option to provide this needed care for aging family members. Maintaining eligibility for means-tested government programs often contradicts the efforts of family members to provide for a quality of life greater than that afforded by means-tested government benefits. Planning for a disabled individual using SNTs provides an opportunity for a better lifestyle for the disabled individual while maintaining eligibility for the critical government benefits upon which they rely. In addition, SNTs give family members peace of mind knowing that funds will be set aside and protected to care for their disabled loved one after they themselves have passed away.

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20 *Dept. of Social Services v. Saunders*, 724 A.2d 1093, 247 Conn. 686 (1999).

21 See After the Judgment, Ellen S. Pryor, 88 Va. L. Rev. 1757 (December 2002) and How to Protect Aged Injury Victims: Implications for Trial Lawyers, Jason D. Lazarus, NAELA Journal, Vol. 4, 2008, Number 2

22 *Board of Overseers of the Bar v. Ralph W. Brown, Esq.*, Me. Sup. Jud. Ct. Docket No.BAR -01-6 (October 25, 2002).

23 MA 404-2