

Special Needs Trusts

A General Overview of Purposes, Limitations and Administrative Keys

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1. Special Needs Trusts are utilized to preserve a Beneficiary's qualification for public benefits.
 - a. This presentation focuses on qualification for SSIⁱ, Medicaidⁱⁱ, SSD
2. Factors indicating when a Special Needs Trust may be advisable:
 - a. *Does the person qualify for some public/government benefit?*
 - i. Is the person age 65, blind or disabled? (42 USC § 1382c(a)(3)(A) and (B))
 1. "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months. The impairment must be so severe that the claimant is unable to do his or her previous work or any other 'substantial gainful activity' which exists in the national economy—meaning work which exists in significant numbers either in the region where such individual lives or in several regions of the country"
 - ii. Citizenship: Must be a U.S. Citizen, or Puerto Rico, Guam or U.S. Virgin Islands, (U.S. Nationals)
 - iii. Income: First \$20 is disregarded, plus first \$65 of earnings and ½ of earnings over \$65. After that, generally, anything of value received in the month is considered income for the month received and a resource for the first day of the next month. (20 CFR §416.1102, 1103)
 1. Cash income reduces benefits dollar- for-dollar from max \$698/month (federal SSI limit) (see, <http://www.ssa.gov/ssi> for calculation models)
 2. For income "deeming" for persons in the home, see(20 C.F.R. § 416.1161(a)-(d)
 3. Earned income: wages before deductions or earnings from self-employment (69 Fed Reg. 62497 (Oct. 26, 2004)
 4. Unearned income: interest, dividends, alimony, annuities, pensions, inheritances (42 U.S.C. §1382a(a)(2))
 5. In-kind Support/Maintenance ("ISM"): not dollar-for-dollar, but based on living arrangements may reduce SSI by up to 1/3 (42 U.S.C. §1382a(a)(2)(A); 20 CFR §416.1131)
 - iv. Resources:
 1. \$2000 of countable resources per single person, \$3000 for a couple living together (includes cash, real & personal property, less exclusions)

2. “Deeming” of resources: any cohabitant’s resources over the applicable limits are deemed yours
 3. Exclusions: Loan proceeds, personal residence, household goods, 1 car, life policies with minimal face value, burial plots or small plans, grants, scholarships, lump sum SSI and SSD payments (retroactive payments) (42 U.S.C. §1382b(a)(7); 20 CFR §416.1233(a)) certain government assistance payments—for one month.
 - v. Other benefits: you must apply, and if you get them, they could reduce SSI (42 U.S.C. § 1382(e)(2); 20 CFR§ 416.210(a),(b))
 - vi. Institutionalization or fugitive status: prison or mental hospital disqualifies; parole violation or fugitive status disqualifies a person
 - b. *Are there assets coming to the disabled person which, if received would disqualify them for necessary public benefits that are “means-tested”?*
 - c. *Did the disabled person already make a transfer of resources that would disqualify them for a public benefit that is “means-tested”?*
 - i. A transfer for less than value within an applicable look-back period can result in a penalty period of ineligibility.ⁱⁱⁱ
 - ii. Some transfers will not result in a penalty: (H.R. 3443 Foster Care Ind. Act of 1999 §206(c)(C)(ii)(I)-(IV)
 1. Transfers between spouses
 2. Transfers to a trust established for sole benefit of a blind or disabled child
 3. Transfers to a (d)(4)(A) and (C) trust
 - d. *If the person is 65 or older, whose assets are at issue?*
 - i. Self-settled trusts cannot be created for persons over age 65
3. Estate Planning options:
- a. Disinherit the child
 - b. Gift to the child and hope it doesn’t ruin them or others don’t exploit them
 - c. Distribute to siblings and hope they do what you ask
 - d. Special Needs Trust
4. Kinds of Special Needs Trusts^{iv}
- a. Third Party Trust (POMS §SI 01120.200 et seq.)^v
 - b. Self-Settled Trust (42 U.S.C. §1396p(d)(4)(A)
 - i. “A trust containing the assets of an individual under age 65 who is disabled (as defined in §1614(a)(3)) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual or a court, if the state will receive all amounts remaining in the trust upon the death of such individual up to the amount equal to the total medical assistance paid on behalf of the individual under a state plan under this title.”

Special Needs Trust Comparative Chart

Issue	Third Party SNT	Self-Settled SNT
Established by:	3 rd party	Parent, grandparent, guardian, court
Funded by assets of:	3 rd party	Disabled Person
Beneficiary:	Disabled Person and/or other	Disabled Person only
Grantor Trustee:	Yes	No
Discretionary Distrib:	Yes	Yes
Inter Vivos:	Yes	Yes
Testamentary:	Yes	No
Revocable:	Can be	No
Grantor Trust:	Can be	Yes
Gift Tax Annual Exclous:	Can use	Cannot Use
Estate Tax	Can be excluded	Includable
Distributions	Pay third parties	Pay third parties
Disability	SSA Definition	SSA Definition
Pay Back Requirement	No	Yes
Medicare Claim	No	Pre-existing claim can preempt trust
Medicaid Lien	No	Pre-existing claim can preempt trust
Age Limit	None	65
Medicaid for Grantor ^{vi}	No	Yes

5. Clarifications for purposes of understanding the chart:

- a. Grantor Trust: where grantor is also the beneficiary
- b. Discretionary Trust: “trustee has full discretion as to the time, purpose and amount of all distributions. The Trustee may pay to or for the benefit of the beneficiary, all of none of the trust as he or she considers appropriate. The beneficiary has no control over the trust.” (POMS §S.I. 01120.200 B 10.)
- c. Residual Beneficiary: Whether a trust has named a residual beneficiary is important in some states in determining whether or not the trust is revocable and, therefore, available for recovery. A residual beneficiary is defined as “not a current beneficiary of a trust, but will receive the residual benefit of the trust contingent upon the occurrence of a specific event, e.g., the death of the primary beneficiary.” (POMS §S.I. 01120.200 B.12)
- d. Supplemental Needs Trust: type of trust that limits the trustee’s discretion as to the purpose of the distributions. This type of trust typically contains language that distributions should *supplement but not supplant* sources of income including SSI or other governmental benefits. (POMS §S.I. 01120.200 B 13)
- e. Self-settled SNT: established by parent, grandparent or guardian of disabled person (or the court). Only the disabled person can be a beneficiary. Inter vivos trust. Irrevocable. The disabled beneficiary must be no older than 65 at the time of creation. At the death of the disabled person, assets remaining in the trust must be made available to pay back any state Medicaid benefits.

- f. Revocability: Self-settled special needs trusts are generally considered irrevocable only because they name a residual beneficiary (payback provision to Medicaid). Otherwise, a trust where the grantor is the beneficiary has revocability issues. In third party trusts, if the grantor attempts to reserve revocation or amendment rights, or even names themselves as a residual beneficiary, revocability issues can arise. Also, POMS holds generally that if a beneficiary can dictate distributions, an equitable ownership exists in trust assets and it is considered “a resource” and could disqualify. (POMS §S.I.01120.200 D.1.b.) However, under general state law, if a trust is irrevocable and under its terms cannot be used by the beneficiary for support and maintenance, it is not a disqualifying resource. This provides the legal basis for a special needs trust.
- g. Third Party SNT: created by someone other than the disabled person with assets not vested in or belonging to the disabled person. The grantor can be the trustee. The trust can be revocable. It can be created by an estate plan provision. A residual beneficiary can be named.

6. Drafting Guidelines:

- a. Trustee Discretion on distributions
 - i. “Assets in the trust shall not be available on demand or direction of the beneficiary. The Trustee shall have full and unfettered discretion as to the time, amount and purpose of distributions, and may pay all or none of the trust for the benefit of the beneficiary as he or she considers appropriate.”
 - ii. Distribution Standard Considerations: if you use the wrong language, it might be considered a support trust.
 - 1. What not to say: “to be utilized for the support and maintenance of the beneficiary” or “to maintain beneficiary’s accustomed standard of living” or “to provide beneficiary with necessities of health, sustenance and safety.”
 - 2. What to say: (precatory language) “trustee shall have full and unfettered discretion as to the time, amount and purpose of all distributions, and may—but is not required to—pay all or none of the trust for the benefit of the beneficiary. Trustee is urged to exercise discretion on behalf of the beneficiary and make distributions for supplemental needs as determined to exist by the Trustee.”
- b. Trust Purpose: don’t make it a “support trust”
 - i. See language samples above
 - ii. “the principal purpose and objective of this Trust is to provide for the management, investment and disbursement of trust assets to promote the Beneficiary’s well being by providing them with supplemental care. It is not the purpose or objective of this trust to provide for or to make expenditures for the Beneficiary’s basic maintenance or support as may be paid for or provided by other sources, or to provide disbursements for the support of the Beneficiary or

in any way supplant available government or other benefits or sources of support.”

- c. “Doctrine of Worthier Title” concerns
 - i. If a trust does not specifically name a residual beneficiary, SSA will consider that the trust is revocable and therefore assets in the trust are available to the lifetime beneficiary.
 - ii. The state (payback provision) isn’t considered a beneficiary, but a creditor, therefore, it isn’t enough to just assume there is a residual beneficiary.
 - iii. It also isn’t enough to just name “heirs at law” or “next of kin.” SSA and multiple courts across the country have held that such a designation does not name a specific remainder beneficiary and therefore, even if there is a payback provision for Medicaid purposes, the trust itself can be considered revocable and can be disregarded.
- d. Consider having the Court authorize and endorse the trust agreement
- e. Include a notification provision upon death of the beneficiary to state agencies.
- f. Third Party Claims/Creditors against the Beneficiary:
 - i. The Restatement (Second) of Trusts provides that an irrevocable, pure discretionary self-settled trust affords no protection from the settlor’s general creditors. (Restatement of Trusts 2nd, §156). Third Restatement of Trusts adopted the same language. Solution (other than a third party trust) is to create the self-settled trust with asset protection provisions)
- g. Include a pre-paid funeral purchase provision. Medicaid payback trumps buying a funeral package, so you need to purchase the funeral during the beneficiary’s lifetime in order to prevent those funds from being used in the payback.

7. Trustee Guidelines:

- a. Disbursements from the Trust
 - i. Income:
 - 1. Cash paid directly from the trust to an individual is unearned income. (POMS §S.I. 01120.200.E.1.a) Therefore, the Trustee should pay third party providers, not the disabled person.
 - a. Example: Jill, a disabled person is receiving SSI. Joan is the trustee of a special needs trust established by Jill’s parents. Jill likes to read the New York Times. Joan arranges with the local distributor to deliver the paper to Jill daily, and pays the bill directly to the distributor. This is not considered income to Jill.
 - ii. In-Kind Support/Maintenance (“ISM”):
 - 1. Disbursements amounting to ISM are food, clothing or shelter received from the Trustee. The “presumed maximum value” rule^{vii} is applied to equate to what extent SSI benefits should be reduced because of such support. If any SSI payment is still awarded, Medicaid eligibility is maintained.

2. The Trustee must be judicious in how much ISM to render in any one month, being certain that the PMV calculation will not reduce the SSI payment to zero.
- iii. Third Party, Non-Income Payments:
 1. The most desirable type of distribution you can make.
 2. Pay directly to a third party, not the beneficiary. "Disbursements from the trust by the trustee to a third-party that result in the individual receiving items that are not food, clothing or shelter are not income. For example, if trust funds are paid to a provider of medical services for care rendered, . . . the disbursements are not income for SSI purposes." (POMS §S.I. 01120.200.E.1.c)
- iv. Periodic Payments: if a beneficiary has a right to mandatory periodic payments, the trust could be considered a resource.
 1. Value of a "vested" interest would be the present value of the anticipated string of payments unless there is some convincing spend-thrift clause that prohibits the anticipation of such payments
- v. Crummey Powers (on 3rd Party irrevocable trusts, generally with insurance policy as an asset)
 1. The Crummey provision is a noncumulative withdrawal right to the beneficiary (necessary if the grantor wants to keep the assets out of their estate)
 2. Problem: If the gift is subject to withdrawal as of the first moment of any month, the funds are a resource to the individual for that month. If withdrawal rights don't begin until after the first of the month, the funds are not resources for that month unless withdrawn.
 3. Solution: make the gift (premium) to the trust at the end of month 1, and make the withdrawal right active after day 2 or 3 of month 2.
- b. Assignment of payments to the trust:
 - i. Some payments cannot be assigned.
 1. Nonassignable Payments
 - a. Temporary Assistance to Needy Families (TANF)
 - b. Railroad Retirement BA (Board Administered) Pensions
 - c. Veteran's Pensions and Assistance
 - d. Federal employee retirement payments (CSRS, FERS)
 - e. Social Security title II and SSI payments
 - f. Private pensions under ERISA (POMS §S.I. 01120.200.F.1.c.)
 2. Assignable Payments can disqualify the beneficiary for SSI unless they are irrevocably assigned to the trust.
 - a. Example: alimony could be irrevocably assigned to the SNT and would not be counted by SSI as income (assuming trust provisions regarding Trustee discretion, etc. are proper)

8. Tax Considerations^{viii}

a. Income tax:

- i. In a simple trust, the income is paid out to the beneficiary and the beneficiary is taxed
- ii. In a special needs trust, income cannot be required to be paid to the beneficiary
- iii. Therefore, SNT need to be complex trusts, which means that they need to be irrevocable (I.R.C. §642(b))
 1. Income paid to or for the benefit of the beneficiary is accounted for on a K-1 of form 1041 and the tax paid by the beneficiary; to the extent that income is retained by the trust, it's taxable to the trust and paid by the trust.
 2. Third Party SNT is almost never a grantor trust. The trust is ordinarily a separate tax payer, with its own tax ID no., and it files its own returns. K-1s are delivered to beneficiary, who reports the income in their tax filings, as applicable.

b. Gift tax:

- i. If a trust is revocable:
 1. contributions by the grantor have no gift tax consequence because they can be taken back. Contributions by third parties are taxable if more than the annual exclusion amount
 2. Distributions from a revocable special needs trust are taxable gifts by the grantor unless less than the exclusion amount.
- ii. If a trust is irrevocable:
 1. Contribution to an irrevocable SNT is usually taxable as a gift unless the grantor retains a power to determine who gets trust distributions. Crummy powers in the trust allow the grantor to utilize the gift tax annual exclusion, but the holder of the Crummy power should not be the disabled person or the grantor (contribution would become an available resource) —so it needs to be another beneficiary.

c. Estate tax:^{ix}

- i. The trust should be drafted to achieve estate tax objectives of the grantor. If estate taxes are not a consideration, a revocable trust can be used until such time as the grantor dies or the trust is funded with assets of a third party.
- ii. A SNT can be funded substantially with investments or life insurance during the lifetime of the grantor, but the grantor can't be the trustee if estate tax savings are the goal. (149 I.R.C. §§2036, 2037) The SNT can be an irrevocable life insurance trust funded with life insurance paid for by contributions from the grantor with appropriate Crummey powers (note: 3rd party must hold powers)
 1. To be outside the grantor's estate, the assets of the trust must be considered taxable gifts at the time the trust was funded. The way to fund the trust is with life insurance and appropriate Crummey powers or simply annual exclusion gifts. One method would be to fund the trust

with assets that are likely to appreciate in value and use some of the grantor's unified credit.

9. Approval of self-settled Trusts

- a. Submit the trust to the local Social Security Administration office for approval—by certified mail. They won't likely send you a letter saying they approve, but they will notify you if they disapprove.
 - i. Letter with the following info:
 1. Disabled person's name and SS number
 2. Receipt of source of funds
 - a. Personal injury closing statement or probate docs showing the amounts and dates of funding
 - b. Trust agreement
 - c. Bank statement showing deposit and any disbursements
 - d. Copy of a Medicaid advisor's letter approving the trust, if applicable.

10. SNAP Fund Trusts

- a. "Special Needs Assistance Program Fund"
- b. State pooled trust set up under Omnibus Budget Reconciliation Act of 1993 (OBRA '93)
- c. Managed by Guardian & Conservator Services, LLC
- d. Process/considerations
 - i. Personal Care Plan
 - ii. Professional manager for regular financial needs
 - iii. Bank of Utah manages the bulk (invested)
 - iv. Initial joinder fee (10% of initial funding amount, capped at \$2000)
 - v. Check writing and annual report fees (\$15/\$175)
 - vi. Case management fee (\$90/hr - when time is spent)
- e. Great option to self-funded trusts
 - i. Pooled with other funds for investment gains
 - ii. professional (neutral/objective) trustee
 - iii. pre-approved trust
 - iv. split Medicaid payback provision—capped at 50% of available funds
 1. balance is retained for investment and indigent cases

ⁱ In order to qualify for the Social Security Administration's Supplemental Security Income Benefits, ("SSI"), a disabled adult can't hold more than \$2,000 in assets, excluding a car and a home. SSI benefits, which average about \$400 per month, must be spent on food, clothing and shelter expenses. Eligibility for SSI makes a disabled person eligible for food stamps and Medicaid, which pays medical expenses, nursing home care and mental health services. Medicaid eligibility also makes a disabled person eligible for many local community services, as well.

ⁱⁱ Generally, Medicaid is a welfare program that pays medical bills for the aged, blind and disabled. It is a medical payment program, not a medical insurance program. It is means-based, with both an income and resource test. (42 U.S.C. § 1396; 42 C.F.R. Parts 430, 431 and 435)

ⁱⁱⁱ SSI and Medicaid have different look-back periods (36 and 60 months respectively). Recent DRA changes make the timing of penalty periods under Medicaid a much more substantial block to planned transfers inside the look-back period.

^{iv} Special thanks to Thomas D. Begley, Jr., for his research paper “Special Needs Trust- In Depth” for a variety of details provided herein.

^v Program Operating Manual System (“POMS”) available at: www.ssa.gov

^{vi} Transfers to revocable trusts will disqualify the grantor for Medicaid; transfers to an irrevocable inter vivos trust will also trigger Medicaid transfer penalties; testamentary transfers to third party trusts don’t take place until after the grantor is deceased, and don’t disqualify the beneficiary; transfers to self-settled special needs trusts are exempt by statute (42 U.S.C. §1396p(d)(4)(A))

^{vii} POMS §S.I. 01120.200E.1.b.

^{viii} If it is desirable that trust income be taxed to the grantor, a grantor trust can be created. (I.R.C. §§673-677) A special needs trust is a grantor trust if revocable. Since most SNT are irrevocable, in order to convert an irrevocable SNT to a grantor trust, the trust can give the grantor the right to require trust corpus by substituting other property/assets of equivalent value. (I.R.C. §675(4)(C)) The power of substitution causes the trust to be a grantor trust for income tax purposes, but does not cause the assets to be included in the grantor’s taxable estate. All income would taxable to the grantor, even if distributed to the beneficiary, but would be gifts to the beneficiary unless contributions into the trust are completed gifts for tax purposes. (Consult a tax attorney)