

By Bernard A. Krooks

Individuals With Special Needs

A variety of options are available to help families handle the complex planning issues they face

Although the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 reduced the importance of estate tax planning for many, it didn't obviate the need for estate plans for non-tax reasons such as asset protection, guardianship, elder law and special needs planning. For families who have members with special needs (for example, an individual who has physical or mental disabilities), the estate planning concerns are magnified. These families face many difficult and complex planning issues in addition to the typical issues faced by all families. After all, what could be more important than making sure the future of a family member with special needs is secure?

Planning must assure appropriate management of finances and personal decisions in the event both parents become disabled or die, with a goal towards avoiding future problems. Parents might also need to continue making decisions for an individual with special needs during adulthood, provide for future residential needs and find someone to care for the individual when they're no longer able.

Unfortunately, there's no "training manual" on how to do things the "right way." In fact, there's probably no single "right" way as the needs and concerns of each individual with special needs are different. Nevertheless, as part of this process, all parents likely need to find necessary care and services, foster the development of independent living skills and make sure their child receives an appropriate education. In addition, they also should maximize financial resources for present and future expenses, which will allow for the high-

est possible quality of life for the individual with special needs and other family members. Often, this involves securing eligibility for government-financed programs and supplementing those programs with private funds.

Although some parents are aware of the array of legal issues they must confront, many arrive at the attorney's office concerned only about what will happen on their deaths and perhaps wondering about a "special needs" trust. Simply put: these are discretionary trusts drafted so that the income and assets aren't counted as resources of the beneficiary with disabilities for purposes of establishing eligibility for means-tested government benefits. Various types of these trusts exist and each one has its advantages and disadvantages.

Other Considerations

Before deciding on a particular planning option, practitioners should consider two issues:

1. **Using a team approach.** Many support groups and community services are available to assist families who have members with special needs. But at some point, it becomes necessary to obtain help from competent professionals. In my experience, the best estate plans developed for families who have members with special needs arise from a team approach. In addition to the special needs planning attorney, it's critical that the family's accountant and its insurance and financial advisors be involved in the process. Of course, the family is an integral part of this process as well. If appropriate, the individual with special needs should be included in these discussions to the extent possible. In these types of situations, practitioners must listen to the needs and concerns of the family and individual with special needs. Only after hearing these needs and concerns can they design an appropriate estate plan.



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2. **Applying for government benefits.** When reviewing the individual's need for governmental benefits, practitioners should distinguish between those that are means-tested and those that aren't based on the individual's income or assets. **Means-tested benefits are reduced or denied when income or assets are above certain limits.** The two primary means-tested benefits that will be important in most instances are **Supplemental Security Income (SSI) and Medicaid.** Both have strict asset and income requirements to qualify. If your client is eligible for Medicaid, it will cover long-term health care, which can be extremely important for an individual with special needs. SSI is a federal program, which provides a monthly income supplement to meet basic needs such as food, clothing and shelter. The various programs have different rules regarding the treatment of unearned income and in-kind support from third parties. These differences often dictate the provisions that should be included in the client's estate planning documents. The goal is to **assure that the individual with special needs isn't disqualified from these programs because of assets placed in his name.**

What's in a Name?

First, let's start with a little nomenclature. If the assets used to fund the trust belong to the individual with special needs, I'll refer to that type of trust as a special needs trust (SNT).¹ A variation of the SNT is a "pooled trust." This is an SNT in which a non-profit organization typically serves as trustee. It has slightly different requirements than an SNT.

If the assets used to fund the trust belong to any person other than the individual with special needs, then I'll refer to that type of trust as a "supplemental needs trust." Some practitioners refer to these types of trusts as "third-party trusts." Keep in mind that there's no one correct name for each of these trusts and that the verbiage may differ among advisors. The most important factor, as we shall discuss below, is whose assets are being used to fund the trust.

SNTs

An SNT is a discretionary trust authorized by 42 U.S.C. Section 1396p(d)(4)(A), enacted as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA-

93). Only an individual with special needs under age 65 can be the beneficiary of an SNT, which must be established by a guardian, parent or grandparent. Thus, without a living parent or grandparent, court intervention is necessary to establish an SNT. Many states have expedited court proceedings so that the trust can be established without a plenary guardianship proceeding. This is the preferred approach if there's no other reason to appoint a guardian for the individual with special needs. For example, an SNT can be for a 45-year-old who has multiple sclerosis with accompanying physical disabilities but wouldn't otherwise need a guardian. If a guardian is necessary because the individual doesn't have legal capacity (as would typically be true in the case of a minor with special needs), then an SNT may be established as part of that proceeding.

Although a parent, grandparent, court or guardian establishes the SNT, the trust is funded with assets belonging to the individual with special needs. That's why many call this a "first-party trust"—it's funded with the assets of the individual with special needs as opposed to someone else such as a third party (for example, a parent). In many cases, the individual receives these funds as a result of a personal injury or medical malpractice lawsuit pursued on his behalf, an inheritance or as child support payments as a result of a matrimonial action. In other cases, when the disability occurs later in life, the individual may have accumulated the assets used to fund the trust before he had special needs.

Pursuant to OBRA-93, the funding of an SNT doesn't trigger a penalty period with respect to the individual's eligibility for Medicaid or SSI. Generally, transfers of assets within the 60-month look-back period will result in a period of ineligibility for Medicaid, and transfers within a 36-month look-back period will result in a period of ineligibility for SSI. However, there's an exception for transfers to SNTs under OBRA-93. Those transfers aren't subject to the transfer-of-asset provisions; therefore, there's no period of ineligibility with respect to SSI or Medicaid as long as the assets are transferred into the SNT while the individual is under age 65. In addition, assets held in an SNT don't count as a resource of the individual with respect to his eligibility for Medicaid or SSI.

In exchange for the foregoing exceptions, an SNT must contain a payback provision requiring that the

trustee, upon the death (or earlier termination of the trust) of the beneficiary, reimburse the Medicaid program out of trust assets the amount of Medicaid expended on behalf of the beneficiary of the trust. The Medicaid payback takes priority over other items such as funeral expenses, claims against the trust estate and residuary beneficiaries. However, trust administration expenses and taxes may be paid prior to satisfying the Medicaid payback. The payback provision doesn't apply to SSI benefits. It should be noted that there's no requirement that the trust have sufficient assets on the death of the beneficiary to fully reimburse Medicaid. The payback is limited to the lesser of the amount of money remaining in the trust or the amount of Medicaid paid on behalf of the beneficiary. In fact, one might argue that in a perfectly administered SNT, the trustee spends the last trust dollar on behalf of the beneficiary just prior to his death.

Federal law requires that all SNTs be irrevocable and that the individual with special needs be the sole beneficiary of the SNT during his lifetime. Upon the death of the beneficiary and the satisfaction of all claims, including the Medicaid payback, residual beneficiaries may inherit trust property. Many states also impose bonding and accounting requirements for the trustee of the SNT. These requirements exist to protect the state's interest in the remainder of the trust. For example, it isn't uncommon for states to require the trustee to notify Medicaid when substantial distributions are made from the trust.

Despite the payback, an SNT makes a lot of sense in many cases since the assets in the trust can be used to improve the quality of life of the individual with special needs. Without an SNT, those assets would have to be spent down on the cost of his care prior to qualifying for Medicaid and SSI. With an SNT in place, these assets can be used to supplement what benefits are available from the government. In addition, the money is paid back to Medicaid without interest. Thus, if the trustee purchases an item today for \$5,000 and the beneficiary dies in 2040, when that same item would cost \$20,000, the Medicaid payback is \$5,000.

Finally, some services aren't readily available without prior qualification for government benefits. For example, there may be group homes or other residential placement services that accept only SSI as payment. In these cases, it may be very important for the individual to have an SNT as that may be the only way to immediately qualify for SSI due to excess resources in the individual's name.

Pooled Trusts

A pooled trust also is a discretionary trust created under OBRA-93. It's created and managed by a non-profit organization. Basically, there's a master pooled trust, and separate sub-accounts are set up to manage the finances of each particular beneficiary. To become part of a pooled trust, the beneficiary typically signs an agreement and transfers his funds to the trust. The funds are pooled together for investment and management purposes, but each person's assets are accounted for in his separate sub-account.

Similar to SNTs, transfers of funds to a pooled trust are exempt from the Medicaid and SSI transfer-of-asset and look-back provisions, and the assets held by the pooled trust aren't considered available with respect to the beneficiary's eligibility for Medicaid or SSI. However, important distinctions exist between pooled trusts and SNTs: (1) the individual with special needs may establish the pooled trust himself. Thus, there's no need to involve a parent, grandparent, guardian or court as is necessary for an SNT; (2) there's no age requirement for a pooled trust. Thus, an individual age 65 or over may join a pooled trust, whereas SNTs may only be created by individuals under age 65. While someone over age 65 may join a pooled trust, the states have varying interpretations as to whether the exemption from the Medicaid and SSI transfer-of-asset provisions apply in those instances; (3) pooled trusts have a modified payback, which allows the remaining trust funds, upon the death of the beneficiary, to continue to be held in trust for the benefit of the remaining pooled trust beneficiaries, as opposed to being repaid to Medicaid.

Pooled trusts are generally a good option for individuals age 65 or over or those who aren't transferring significant funds to the trust and don't want to incur the expense of setting one up and having it administered. With a pooled trust, these tasks are taken care of by the non-profit organization, which also professionally manages the funds as trustee. Of course, the individual has more flexibility to select his own trustee when opting for an SNT.

Supplemental Needs Trusts

Supplemental needs trusts, like SNTs and pooled trusts, are discretionary trusts created for the benefit of an individual with special needs. However, unlike SNTs and pooled trusts, supplemental needs trusts are funded by anyone other than the individual with special needs. Although there's no federal statute authorizing the use of supplemental needs trusts, many states have their

own statutes or case law authorizing them.

If an individual needs—and qualifies for—means-tested benefits, an outright distribution to him or a bequest to a support trust will make him ineligible for Medicaid or SSI. Property held in a properly drafted supplemental needs trust, on the other hand, won't affect the individual's eligibility. The income and assets of the trust can thus be devoted to improving his quality of life and supplementing what he receives from government benefit programs. A supplemental needs trust is a completely discretionary trust and the beneficiary can't have any right to compel distributions from the trust. In addition, the trust should prohibit the trustee from making any payments directly to the beneficiary, as this may result in reduction or disqualification from government benefits.

If you're working with a client who has a child with special needs, the client can: (1) include the child in the estate plan through an outright distribution, (2) disinherit the child, (3) distribute the share of the child with special needs to his sibling and rely on moral commitment of that sibling to "take care of the child," or (4) create a supplemental needs trust. Making an outright distribution to the child with special needs will result in disqualification for Medicaid and SSI. Disinheriting the child, while solving the Medicaid and SSI problem, doesn't improve his quality of life, which is likely to be very important to the parents. Leaving the share of a child with special needs to a sibling may seem appropriate in theory, but often doesn't work in practice. The best laid plans of relying on "moral commitment" often go astray, especially after the parents die and new parties become involved in the process (for example, through marriage). Thus, the surest way to provide a good quality of life for the child with special needs is through a supplemental needs trust.

A supplemental needs trust may be established by any adult with capacity. Unlike an SNT, the beneficiary needn't be under age 65. Moreover, upon the death of the beneficiary, there's no requirement that Medicaid be paid back for the cost of care expended on behalf of the beneficiary. The reason there's no Medicaid payback required is that the assets used to fund the trust don't belong to the individual with special needs. Unlike an SNT, the parent is typically not relying on an exception to the Medicaid and SSI transfer-of-asset provisions to fund the trust.

A supplemental needs trust may be set up as a testamentary trust in a client's will or as an inter vivos trust during his lifetime. A testamentary trust can be used when gifts to the trust won't be made until the parents' death. A benefit of an inter vivos trust is that

parents or others can make contributions during their lifetimes or at death. The inter vivos supplemental needs trust can thus act as a receptacle for gifts from others who won't be required to incur the expense of creating a supplemental needs trust as part of their estate plans. Moreover, the funds available to assist the individual with special needs will all be part of a single trust. Many families find this to be a very attractive option. Although an inter vivos supplemental needs trust can be irrevocable or revocable, it should probably be irrevocable as other donors may be disinclined to make gifts to a supplemental needs trust if the parents can revoke it at any time.

Caveat Emptor

Special needs planning is an extremely complex area of the law. Practitioners must be familiar with federal and state statutes and regulations, as well as local practices. A lot can go wrong, resulting in grave consequences to the family and individual with special needs. Here are two tips to help you avoid some minefields:

(1) No one other than the individual with special needs should ever contribute assets to an SNT. If a third party wants to set aside funds for an individual with special needs, he should set up a supplemental needs trust and contribute the assets to that trust. This way, those assets aren't subject to the Medicaid payback contained in the SNT.

(2) If an individual is the beneficiary of both an SNT and a supplemental needs trust and you're the trustee or you're advising the trustee, make sure that you spend the assets of the SNT prior to tapping into the supplemental needs trust. That's because the assets in the SNT are subject to the Medicaid payback while those in the supplemental needs trust aren't.

Rewarding Process

While this may be a complex area of practice, it's also very rewarding. When we work with parents who are raising a child with special needs, they've shared with us that they feel like a huge weight has been lifted off their shoulders after they've gone through this process. While parents can't predict the future for their child with special needs, they take great comfort in knowing that they've done what they can do to ensure the best quality of life for their child. 

Endnote

1. Other names for this type of trust include "first-party trust," "self-settled special needs trust," "payback trust" or "(d)(4)(A) trust."