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Leveraging Special Needs Trusts to Obtain Public Benefits

Crafting First Party, Third Party, and Pooled Special Needs Trusts

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DRAFTING THE SPECIAL NEEDS TRUST

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I. General. It is critical that the drafting attorney understand the differences between first- party and third-party special needs trusts.

A. Questions to be Answered in Establishing a self-settled trust?

1. Was the trust established with the assets of an individual under the age of 65?
2. Was the trust established with the assets of an individual with disabilities?
3. Is the individual with disabilities the beneficiary of the trust?
4. Did a parent, grandparent, legal guardian, or court establish the trust?
5. Does the trust provide specific language to reimburse the state, upon the individual's death for medical assistance paid?

B. First-party SNTs and Third Party SNTs contain common provisions but if a first-party SNT doesn't address the above five issues the trust won't be in compliance with the §1396 d(4)(A) of the federal code. The trust will be counted as an available resource or subject to the transfer of asset penalty.

C. Irrevocability. A second important difference is that a first-party SNT must always be an irrevocable trust. A third- party SNT can be revocable. For example a parent establishing a third-party trust for his or her disabled child may be more comfortable with a revocable trust. The trust becomes irrevocable upon the death of the parent. But a first party trust must always be irrevocable. If the first-party SNT was revocable the assets would be available resources and the beneficiary would lose needs based benefits such as SSI or Medicaid.

II. Special Provisions in Drafting the First-party SNT

A. Opening provisions.

1. Declare how the trust came to be established whether by court, parent, grandparent or guardian.

2. Describe the nature of the trust and that it is established in accordance with state law and with 42 U.S.C. § 13969(d)(4)(A).

3. Declare that the trust is irrevocable.

B. Purposes Clause

1. Use it to state that trust assets are set aside for the beneficiary's special, supplemental, or emergency needs. The trust documents should not refer to health, maintenance, and support since it may invite an interpretation that the trust should pay for those services.

2. Provide Information about the Beneficiary – date of birth; specific disability; public benefits received. Use this provision to prove that the beneficiary is under 65.

3. Declare that the trust is fully discretionary. It's important for the trust to specifically state that the beneficiary does not have the authority to direct the trustee to make distributions from the trust for any purpose, including paying for the beneficiary's food, clothing, or shelter needs.

C. Distribution Provisions. The trust should not direct that distributions be made for the support, health, or maintenance of the beneficiary. Avoid any language that could interpret the trust as a support trust. Instead distributions are to be made for the beneficiary's special needs.

1. Special needs can be described as items or services that the trustee considers necessary for the beneficiary's health, protection and welfare that cannot be met with government provided services. Give examples of special needs:

a. Procurement of sophisticated medical or psychological treatments, dental treatment, rehabilitative or educational training.
b. Items that will enrich and make the beneficiary's life more enjoyable.
c. Recreational opportunities.
d. Maintenance of contact with family members.
e. Advocacy, including personal care consultant.

2. Authority to Impact Government Benefits: Gives discretion to the Trustee to provide in-kind support in spite of any partial reduction in benefits. Trustee shall make such a determination when:

a. Beneficiary's needs are better met if such distribution is made.
b. The distribution is in the best interest of the beneficiary.

D. Termination Provisions. Because the first-party trust requires pay-back to the state upon the death of the beneficiary of all medical expenses paid under Medicaid, attention must be paid to the termination provisions of the trust.

1. Fees and administrative expenses may be paid during the life of the beneficiary as permitted by the trust document.

2. Some expenses may be paid at the individual's death before reimbursement of medical assistance to the state, including:

a. taxes due from, the trust to the state or federal government because of the death of the beneficiary.

b. reasonable administrative expenses such as an accounting of the trust to the court.

3. The following expenses and payments upon the individual's death may not be permitted before reimbursement of the state for medical assistance.

a. inheritance taxes due for residual beneficiaries.
b. debts due third parties.
c. funeral expenses (other than prepaid funeral expenses)
d. payments to residual beneficiaries.

E. Trustee Selection. The beneficiary can never be the Trustee and the document should state that. Frequently the beneficiary's family member will become the Trustee. Usually, the family is not experienced with investments and public benefits. Also, family members when serving as trustees may have a conflict of interest. Consider having an experience and independent professional or corporate fiduciary serve as trustee or co-trustee. But make sure the corporate trustee is familiar with public benefits and disbursement issues.

F. Trust Protector. The trust agreement can designate a 'trust protector' with the authority to remove and replace the serving trustee if the trustee does not adequately discharge his other fiduciary duties. The Trust Protector can also be given authority to amend the SNT to comply with changes in IRS and applicable public benefit provisions. If the trustee is a private professional fiduciary a trust protector can be used to oversee the corporate entity and help recommend distributions.

G. Prohibition of Contributions After Age 65. If assets are added to the trust after the beneficiary with disabilities reaches age 65, the amount added will be treated as a countable resource for SSI and Medicaid. Therefore, the trust should be drafted to expressly authorize the trustee to refuse to accept additional contributions to the trust after the beneficiary attains age 65.

H. Spendthrift Provisions. The trust should contain a provision protecting the trust assets from the claims of the beneficiary's creditors and prohibit assignment by the beneficiary.

I. Qualification & Public Accountings. If the first-party SNT is established by a court or guardian, the trust agreement should state whether the trustee is required to qualify as trustee before a court of file public accountings with the court. Usually bond with security cannot be waived if the trust was established by a court or guardian.

J. Grantor Trust Status. Because of the compressed tax rates for trusts and the beneficiary's normally low marginal income tax rate, the attorneys should consider drafting the trust an 'intentionally defective' grantor trust.

III. Drafting Third-party Special Needs Trusts

A. General. Attorneys often draft third-party SNTs for parents or grandparents who have children with disabilities. They want the child to be eligible for needs-based benefits but they want to assure that resources are available to provide and protect the child upon their death. A person may also wish to establish a trust for a surviving spouse with disabilities who may be receiving needs-based benefits.

1. It's important to draft the trust so that it will not be considered a resource of the beneficiary. SSA POMS requirements and Medicaid law will consider the trust an available resource if the disabled beneficiary has authority to revoke the trust and then to use trust assets to meet his food or shelter needs, or if the individual can direct the use of the trust principal for his or her support and maintenance.

2. Again, the trust should specifically state that the beneficiary does not have authority to revoke the trust or direct the trustee to make distribution from the trust for any purpose.

B. Purpose Clause. The trust should explicitly state that the grantors (parents or grandparents) intend that the trust assets are set aside for the beneficiary's special or supplemental needs. Avoid any language that enables someone to interpret the trust as a support trust or a discretionary trust with a support standard.

C. Non-Reduction Clause. A non-reduction clause states that the trustee should only use the trust funds to provide for the beneficiary without reducing or eliminating services or financial assistance for basic maintenance, support, residential, medical or dental care that the beneficiary may receive in his or her own right from any local, state or federal government agency. The clause also provides that the trust will not use any portion of the trust estate, whether income or principal, to reimburse any local, state, federal or private agency for basic maintenance, support, medical and dental care received by the beneficiary in his or her own right.

E. Emergency Clause. An emergency clause permits the trustee to contravene the 'non-reduction' principle that trust assets should not be used if they would cause loss of public benefits. The trustee is given discretion to determine the existence of an 'emergency' which loosely defined would arise when available public resources were so inadequate the primary needs of the beneficiary could but be met without the intervention of the trustee.

F. Discretion Clause. The trust should declare that the Trustee has sole and complete discretion when considering distributions of income or principal to meet the beneficiary's needs.

G. Day-to-Day Care. The SNT becomes the primary vehicle for providing care and services to the beneficiary for the remainder of the beneficiary's life whatever level is appropriate for his or her needs.

> 1. Specific authority can be given in the trust for the Trustee to engage the services of a care manager. A care manager is a licensed clinical social worker, geriatric care manger or similar professional who can be hired to prepare a care plan and monitor the plan throughout the life of the beneficiary. The care manager becomes the eyes and ears of the SNT trustee, visiting beneficiary regularly to insure proper care is provided.
>
> 2. Specific authority can be given in the trust for the Trustee to hire advocates who can be used to assist the trustee in determining whether certain SNT disbursements are appropriate even if they do reduce benefits.

H. Housing. One of the most complicated choices for the trustee is the issue of housing for the beneficiary. An SSI recipient can own a home in their own name without losing benefits. On the other hand the SNT can purchase and hold title to provide shelter to the beneficiary. Authority should specifically be given in the trust to allow the trustee to purchase a residence. If the beneficiary resides in the home and receives SSI he or she may face a 1/3 reduction in SSI benefits based on receipt of in-kind support and maintenance. If the beneficiary receives SSDI the 1/3 reduction does not apply.

I. Powers of the Trustee. The trust should expressly enumerate the trustee's powers. At the very least it should incorporate by reference the powers and duties enumerated in sections of the state code that address fiduciary powers.

J. Trustee compensation and administrative fees. The trust should authorize the trustee to pay himself or herself reasonable compensation in accordance with express provisions in the trust or an applicable statute. The trust should contain express authority for the trustee to pay reasonable legal fees, care management fees, taxes and administrative expenses form the trust.

K. Retirement Plan Distributions. Because retirement plan accounts are frequently a significant portion of the savings of parents with children having special needs, the parents will frequently designate the third-party SNT as the beneficiary of these accounts after both parents are deceased. The drafting attorney must take caution when dealing with this issue.

1. A conduit trust, which simply passes the minimum distribution from the trust to the beneficiary, is not suitable if the beneficiary is on SSI or Medicaid because distribution from the trust will be income for eligibility determination.

2. If the third-party SNT is the beneficiary of the retirement plan benefits, it should be drafted as an 'accumulation trust'. An accumulation trust permits the trustee to accumulate minimum required distribution in the trust principal and make distribution for the benefit of the disabled beneficiary in the trustee's discretion.

L. Planning to Obtain an Annual Exclusion for Contributions to the SNT. Where the third-party SNT is being established inter vivos, the drafting attorney should consider whether it ought to contain provisions enabling the trustee to receive current contributions that qualify for the Federal Annual Gift Tax Exclusion (so called Crummey Powers). However, unlike conventional Crummey Power planning, the SNT beneficiary cannot be a recipient of the Crummey Power. The drafting attorney should name a person other than the SNT beneficiary. A non-disabled remainder beneficiary could qualify.

M. Termination Clause. Permits the trustee to terminate the third-party SNT in favor of other family members if and when the trust estate becomes liable for services that otherwise would be provided through public programs. If the law changes that would make SNT assets available resources the trustee has the power to end the trust and distribute to the remainder beneficiary's. This power should be only in the trustee. The disabled beneficiary should have no such power.

O. Remainder Beneficiaries. Because there is no pay-back requirement include remainder provisions if trust assets remain after the death of the primary beneficiary. Even in the first-party trust remainder beneficiaries should be included.

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Leveraging Special Needs Trusts to Obtain Public Benefits: Crafting First Party, Third Party, and Pooled Special Needs Trusts

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I. INTRODUCTION

Planners are often confronted with a client's concern about who will care for a disabled family member after they die. They often are concerned that the cost of long term care will deplete the disabled family member's assets and that there may not be sufficient resources available after they are gone.

Many clients know that their resources will be inadequate to provide quality care for their disabled family member for life without the assistance of public benefit programs such as Medicaid and Supplemental Security Income ("SSI"). The creation of a special needs trust can accomplish the dual goal of preserving the disabled family member's eligibility for such programs and providing a vehicle to hold additional funds from that person or funds contributed by a parent or other family member to supplement those government benefits. Depending on the circumstances, the trust can be established and funded with the assets of the disabled person's parents or other family member either by Will at death or by living trust during lifetime (hereinafter sometimes referred to as "Supplemental Benefits Trusts"). Alternatively, as later discussed, a special needs trust can be funded with the assets of the disabled person so long as the trust is established by the disabled person's parent, grandparent, legal guardian or by a court (hereinafter sometimes referred to as "Special Needs Trusts).

Separately, couples addressing their own long-term care needs may ensure that assets are available to supplement any government benefits available to the survivor of them. A testamentary Supplemental Benefits Trust may be an effective tool to accomplish the dual goals of maintaining the government benefits of surviving spouse or domestic partner while ensuring that assets are available for the survivor's supplemental care and support.

Note: State law widely varies with respect to special needs trust drafting requirements, trust administration and liens. Accordingly, this outline focuses on the federal law. **PLANNERS SHOULD CONSULT WITH LOCAL ATTORNEYS TO DETERMINE STATE LAW REQUIREMENTS.**

II. TRUSTS FOR THE BENEFIT OF A DISABLED BENEFICIARY

A special needs or supplemental benefits trust is a special type of trust that is intended to allow the beneficiary to continue to qualify for certain needs-based government benefit programs, even though the beneficiary may have thousands (or hundreds of thousands) of dollars in trust for his or her benefit. Generally speaking, a special needs trust is simply a discretionary spendthrift trust. The types of special needs trusts can be categorized broadly as follows:

A. Special Needs Trust: A Special Needs Trust is funded with the assets of the disabled beneficiary, such as proceeds of a personal injury action on behalf of the beneficiary or inheritances or gifts received by the beneficiary before the creation of the trust. A Special Needs Trust is authorized by, and must comply with, federal law. *See* 42 *U.S.C.* § 1396p(d)(4)(A).

B. Supplemental Benefits Trust: A Supplemental Benefits Trust is funded with the assets of someone other than the beneficiary (*e.g.*, parents who have created a Supplemental Benefits Trust funded with gifts effected during lifetime by them or others for the benefit of a disabled child who receives some type of public assistance, or a testamentary trust created by a parent, spouse, domestic partner or other third party).

C. General Trust Requirements

The laws and regulations governing the applicable benefit programs affect special needs and supplemental benefits trusts in two unique ways:

1. Supplement, not supplant, government benefits: Regardless of who creates the trust, the beneficiary will be disqualified from government benefits if the trust assets are used to purchase too many "countable resources" or provide the beneficiary with too much "income" or "in-kind income."

(a) Definition of “special need” or “supplemental benefit”: There is no definitive explanation of a "special need" or “supplemental benefit.” Special Needs Trusts are typically required to state that the purpose of the trust is to use trust assets to supplement, not supplant, impair or diminish, any benefits or assistance of any federal, state or other governmental entity.

It is probably easier to determine what is not a "special need" or “supplemental benefit.” The term does not include the basic necessities of life, such as food, clothing, shelter and utilities. Nor can it include incidental spending money (which will be considered unearned income), gifts to friends or relatives (which will not benefit the beneficiary, and will adversely affect a state’s right to repayment upon termination (if applicable)), or insurance on the life of the beneficiary (which will be a countable resource, will not benefit the beneficiary and which will adversely affect New Jersey's right to repayment upon termination (if applicable)).

Likewise, special needs or supplemental benefits should not include items or services that are available from the government benefit programs, since the purpose of the trust is to maintain eligibility for those programs.

2. <u>Estate Recovery</u>: Special Needs Trusts must contain certain provisions requiring repayment of certain government benefits (in particular, Medicaid), upon termination. State regulations may provide that a right of recovery may apply to the assets held in a testamentary trust established by a third party, including a community spouse for the benefit of the surviving beneficiary spouse, to the extent that the assets in the predeceased third party's individual name at death, used to fund such trust, had been transferred to him or her from the disabled beneficiary within a certain time period from the disabled beneficiary's Medicaid eligibility. *See, e.g., N.J.A.C.* 10:49-14.1; *Estate of Michael DeMartino v. State of New Jersey, Division of Medical Assistance and Health Services* 373 N.J. Super. 210; 861 A. 2d 138 (App. Div. 2004), *certif. denied*, 182 N.J. 425 (2005).

III. <u>SPECIAL NEEDS TRUST -- ESTABLISHED WITH THE ASSETS OF THE DISABLED INDIVIDUAL</u>

A. <u>Overview</u>

Special needs trusts, funded by assets of the disabled individual, are authorized under the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93"), and codified at 42 *U.S.C.* § 1396p(d)(4)(A).

1. A special needs trust is an attractive option for individuals disabled as a result of medical malpractice or other types of personal injury or who are disabled and otherwise have assets. Settlement or jury award proceeds are treated as assets owned by the disabled individual but can be placed in the trust without disqualifying the individual for Medicaid or SSI benefits. Under federal law, such a trust is authorized to be established by the individual's parent, grandparent, legal guardian or a court if the individual is disabled and under age 65 at the time the trust is created. 42 *U.S.C.* § 1396p(d)(4)(A).

2. The definition of disability for such a trust is the same as that contained in the Social Security Act which is used to determine eligibility for SSI or Social Security Disability ("SSD") benefits. *See* 42 *U.S.C.* § 1382c(a)(3)(A). "An individual shall be considered to be disabled for purposes of this subchapter if he is 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 (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity)." *Id.*

3. Unlike a trust created and funded with the assets of a parent or third party for the benefit of a disabled individual, a special needs trust created under these statutory provisions is called a "payback trust" or "OBRA '93 trust" since, upon the death of the disabled individual, any state which paid medical assistance on behalf of the individual (*i.e.*, under a Medicaid program), must be reimbursed, in accordance with Medicaid and SSI requirements, from any funds remaining in the payback/OBRA '93 trust. The state is entitled to reimbursement up to an amount equal to the total medical assistance paid by that state. 42 *U.S.C.* § 1396p(d)(4)(A).

B. Federal Drafting Requirements

1. If the trust is to be funded with assets of the beneficiary, the beneficiary's parent, grandparent, legal guardian or a court must create the trust. Federal law requires that the following three conditions be met in order for the trust to be considered an excluded resource:

    (a) The beneficiary must be under age 65 when the trust is established and funded. (Turning 65 thereafter does not affect the validity of the trust.)

    (b) The beneficiary must be disabled.

    (c) Both Medicaid and SSI require that the trust contain a provision that upon the death of the beneficiary or earlier termination of the trust, any state agency that has provided Medicaid benefits must be repaid out of the trust up to the amount of the benefits provided during the existence of the trust.

    See 42 *U.S.C.* §§ 1396p(d)(4)(A), 1382b(e)(5) and 1382b(c)(1)(C)(ii); *N.J.A.C.* 10:71-4.11(g)(xii).

C. State Drafting Requirements

1. State law widely varies with respect to special needs trust drafting requirements. Planners should consult with local attorneys to determine state law requirements.

IV. COURT-CREATED SPECIAL NEEDS TRUSTS – UNIQUE DRAFTING ISSUES

If the Trust is to be created or authorized by a court (as described above), the court may insist that it supervise the administration of the trust. Although the type and extent of supervision varies from state to state, county to county, and even from judge to judge, court supervision will typically entail the following items:

A. Accountings

The court may require that accountings be filed periodically with it for its approval. The proposed judgment approving the creation of the trust should be reviewed to determine whether accountings are proposed to be required, how often they are proposed to be required and in which court they are proposed to be filed.

B. Trustee's Commissions

The court may require that it approve the trustee's compensation. The proposed order approving the creation of the trust should be reviewed to see whether any fiduciary will be allowed to take fees on account, what amount of fees on account it will be allowed to take and how often it will be required to seek court approval of its fees.

C. Investments

With respect to the requirement that investments be limited, the proposed order approving the creation of the trust should be reviewed to ascertain whether any investment limitations are proposed to be made. Absent any specific investment limitation, the "prudent investor rule" may apply in certain states such as New Jersey.

D. Limitations on Purchases of Major Assets

Courts may require that purchases of large items such as homes and vehicles (often vans that are specially equipped to transport disabled persons) be approved in advance. The proposed judgment creating or authorizing the trust should be reviewed to ascertain whether any such limitations are proposed.

E. Seed Trusts

Some regions require the trust to be nominally "seeded" by the nominal grantor.

F. There are a number of government benefits programs which must be considered in effecting a proper tort recovery settlement or award and a special needs trust, or otherwise protecting a disabled individual's assets in this regard. These programs include SSI, Medicaid, SSD, Medicare and Federally-Assisted and DDD Housing.

1. SSI. A federal welfare program found at Title XVI of the Social Security Act, 42 *U.S.C.* §§ 1381, 1381a. SSI provides the recipient with a cash benefit to cover the basics of living which are food, and shelter. SSI is a means-tested program. SSI benefits are reduced dollar-for-dollar for "countable income." An SSI recipient may not have more than $2,000 of countable resources. Resources not countable include the principal residence of the SSI recipient, household goods, and cash or cash equivalents not exceeding $2,000 (20 *C.F.R.* § 416.1216(a)-1216(b)), an automobile of any value if it is used for the transportation of a disabled person or a member of his or her household (20 *C.F.R.* § 416.1218(b)(1)). A special needs trust for a tort victim should be structured to limit the income to the recipient so that SSI benefits are not reduced or lost, and so that trust assets in excess of $2,000 remain "unavailable" to the recipient.

   Section 205 of the Foster Care Independence Act of 1999 (amending 42 *U.S.C.* § 1382b) provides that the assets of any trust (revocable or irrevocable) funded with property of the SSI recipient (or the recipient's spouse) are deemed countable resources for the purpose of SSI eligibility. Section 205 applies to trusts created on or after January 1, 2000. **The Act excludes special needs trusts for disabled persons under the age of sixty-five (65), created pursuant to 42 U.S.C. § 1396p(d)(4)(A).**

2. Medicaid. A federal and state program which covers a very broad spectrum of medical services including hospital stays, physician services, community-based health care and nursing services. There are no deductibles, co-payments or coverage limits. The federal statute governing Medicaid is 42 U.S.C. § 1396 *et seq*.

3. SSD. A federal cash benefit program administered by the Social Security Administration. Unlike SSI, it is not a means-tested program. SSD is an insurance program based on the Social Security earning records of the SSD recipient. However, if a child becomes disabled prior to attaining the age of 22, his eligibility can be based upon the earnings record of a retired or deceased parent. The amount of the recipient's monthly check is dependent on the amount paid into the system.

4. Medicare. The Medicare law is found at Title XVIII of the Social Security Act and is found at 42 *U.S.C.* § 1395. Medicare is a federal medical insurance program available to persons over 65 and disabled persons. The test for disability is found at 42 *U.S.C.* § 1382c(a)3A. The program is not means-tested.

5. Federally-Assisted Housing. Programs providing for subsidized housing are found under 42 *U.S.C.* §§ 1437-1440, including Section 8 rental assistance

for low income families. Governing regulations are found at 42 *C.F.R.* §§ 813.101-813.110.

G. Liens. Medicaid and Medicare impose liens against a tort recovery for monies expended. **Planners should consult with a local attorney to determine whether state or local agencies also have liens.**

1. The Medicaid Lien. Federal law at 42 *U.S.C.* § 1396a(a)25(A) and (B) requires each state Medicaid program to ascertain the legal liability of third parties to reimburse for medical assistance provided by the state and to recover from third parties the cost of medical assistance provided.

(a) An award to a disabled child's parents may deemed an award to the child for the purpose of Medicaid recovery.

(b) In *Arkansas HHS v. Ahlborn,* 126 S. Ct. 1752 (2006), the United States Supreme Court held that Federal laws requiring a Medicaid recipient to assign payments from third parties only extended to medical care and did not allow state Medicaid agencies to collect on amounts attributable to future expenses, permanent injury and lost earnings.

(c) Care should be taken to notify the appropriate agencies where a lien may exist. Failure to do so may result in the attorney's liability for satisfaction of the lien.

2. Medicare.

(a) The Medicare Secondary Payor Program (MSP) 42 *U.S.C.* § 1395y(b)(2) governs all claims for recovery of Medicare payments related to medical services provided in connection with accidents or injuries. All Medicare payments are secondary when the payment with respect to the injury could or should be made by workers' compensation insurance, liability insurance or no-fault insurance.

(b) Medicare's right of recovery has priority over any subrogated right, and also has priority over Medicaid. The only exception is that an HMO can pursue its own subrogation rights pursuant to 42 *C.F.R.* § 471.528. Medicare is not bound by a settlement made between the beneficiary and the responsible party. Medicare may pursue its own claim against the liability insurer. If the liability insurer does not properly pay Medicare, Medicare has the right to take legal action against the insurer and to collect double damages. 42 *C.F.R.* § 411.24(i).

(c) Medicare considers all monies recovered to be related to medical expenses, regardless of how they are characterized. Medicare will recognize allocation of liability payments for non-medical loss only when payment is based upon a court order specifically designating amounts that are paid for "pain and suffering" or not related to medicals.

(d) Medicare will recognize under 42 C.F.R. § 411.37(c) a proportionate share of the necessary procurement costs incurred in obtaining a settlement. Procurement costs are court costs and attorneys' fees. Medicare's payment from the beneficiary is reduced by the proportionate share of procurement costs.

(e) Counsel for the Medicare beneficiary must notify Medicare as to any possible settlement prior to final settlement or adjudication of the case on its merits. Medicare will then stipulate to its claim, thus preventing subsequent charges from being added to its claim amount. A Medicare claim may be asserted even against the estate of a deceased beneficiary.

(f) **Note**: Changes in the Medicare regulations in 2003 removed the prohibition against a medical provider billing a liability insurer or placing a lien against the settlement for Medicare covered services by deleting a portion of 42 CFR § 411.54(c)(2) containing that prohibition.

(g) The Medicare, Medicaid, and SCHIP Extension Act of 2007 (MMSEA) establishes reporting requirements that will allow Medicare to examine personal injury settlements and awards to ensure that conditional payments are identified and reimbursed. If the settlement does not contain an allocation, Medicare has a statutory right to recover up to the entire amount of the settlement, judgment or award. MMSEA does not change current practices regarding Medicare set-aside agreements (MSAs) but it does make clear that Medicare will concentrate on enforcement and recovery regardless of whether it's a personal injury or workers compensation claim. The new regulations require information regarding the Medicare beneficiary claimant to be reported to the Centers for Medicare & Medicaid Services (CMS) with a penalty of $1,000 per claim per day for non-compliance. A Medicare Set Aside Trust is one option.

H. <u>Structured Settlements and Special Needs Trusts</u>

1. In some instances, the settlement may consist of a structured settlement as well as a special needs trust. A structured settlement commonly involves the purchase, by the defendant's insurance carrier, of an annuity calculated to pay certain sums at regularly scheduled intervals in the future. Insurance carriers

representing defendants in a personal injury case often favor a structured settlement because they can settle the case for less money up front than the actual value of the case. In addition, the structured settlement is sometimes favored by plaintiff's counsel, who may be concerned about the availability of large sums of money to the guardian or trustee of a special needs trust.

2. Structured settlement payments made directly to the injured party may render the beneficiary ineligible to receive government benefits. A judgment involving both a structured settlement and a special needs trust should direct the periodic payments from a structured settlement to "pour over" into the special needs trust.

3. On August 20, 1996, I.R.C. § 104(a)(2) was amended to repeal the exclusion from gross income for punitive damages awarded in a civil action other than a wrongful death action or an action in which only punitive damages may be awarded under applicable state law.

CHECKLIST FOR SPECIAL NEEDS TRUSTS (SUCH AS WITH THE PROCEEDS FROM THE SETTLEMENT OF LITIGATION)

1. Check for compliance with the federal law.
   - A. Is the beneficiary under age 65?
   - B. Is the beneficiary "disabled?"
   - C. Is the trust created by the beneficiary's parent, grandparent, guardian or by the court?
   - D. Does the trust contain a provision requiring repayment of the state Medicaid program upon termination of the trust?
2. Check for compliance with state requirements.
3. Verify that the statutory liens have been paid prior to the funding of the trust.

V. SUPPLEMENTAL BENEFITS TRUST ESTABLISHED WITH ASSETS OF PARENTS, SPOUSE, DOMESTIC PARTNER OR OTHER THIRD PARTY

A. A parent, spouse, domestic partner or other third party who leaves a disabled individual his or her assets outright by Will or living trust may jeopardize the disabled individual's eligibility to receive public benefits. To avoid that outcome, the Will or living trust of a parent, spouse, domestic partner or other third party can provide that the assets, including the home, if desired, be put into a supplemental benefits trust for the disabled individual's benefit.

B. Under the terms of a properly drafted supplemental benefits trust, the disabled individual has no control or access to the trust funds. Therefore, the funds are not considered a resource available to the disabled individual for purposes of Medicaid or SSI eligibility.

C. Rather than permit the trustee of the supplemental benefits trust to make cash distributions to the disabled individual or pay for the disabled individual's primary needs, the trustee should have the discretion only to pay for supplemental goods and services that are not covered by public benefits. For example, the trustee should have the discretion to use trust funds to maintain the disabled person's home as well as for travel and entertainment. If the individual is physically disabled, the trustee could use the funds to pay for a specially equipped van or home to accommodate his or her physical needs.

D. The spouse or domestic partner of a disabled individual also may wish to leave some or all of his or her estate in a testamentary supplemental benefits trust for the benefit of the public benefits recipient spouse or domestic partner. **Note**: Consult with a local attorney to determine whether state law permits such dispositions.

E. Specific dispositive provisions should be included for final disposition of the assets of the supplemental benefits trust. Generally, government agencies will not need to be repaid. State regulations may require that notice be given to the state Medicaid agency of the death of the Medicaid beneficiary. It is prudent when any supplemental benefits trust terminates, therefore, to ascertain whether the state Medicaid agency (or any other creditor) has an enforceable claim against the trust assets.

F. <u>Estate Recovery</u>: State regulations may provide that a right of recovery may apply to the assets held in a <u>testamentary</u> trust established by a third party, including a community spouse or domestic partner for the benefit of the surviving beneficiary spouse or domestic partner, to the extent that the assets in the predeceased third party's individual name at death, used to fund such trust, had been transferred to him or her from the disabled beneficiary within a certain time period prior to the disabled beneficiary's Medicaid eligibility.

G. <u>Accountings</u>: The state may require periodic accountings by the trustee.

H. <u>Tax Treatment of Trust</u>: Unless it is an elective share trust which requires all income to be paid to the surviving spouse, a testamentary supplemental benefits trust will be taxed as a complex trust. Accordingly, as distributions are made to the beneficiary, whether from income or principal, the beneficiary will be taxed with his or her proportionate share of "Distributable Net Income" ("DNI"). To the extent that distributions from the trust do not equal "Net Accounting Income" or are less than DNI, the trust will pay tax on accumulated income at the federal and state level. Further, the trust will pay tax on short and long term capital gains. In the event that the trust incurs capital losses and to the extent those losses were not applied to other current year gains, the losses will be used to reduce accumulated income, if any. By contrast, an elective share trust will be taxed as a "simple trust" since all of the income will be required to be paid to the surviving spouse; short and long-term capital gains will be included in DNI and taxed to the trust unless otherwise distributed to the spouse.

I. <u>Trust Administration Issues</u>: The "needs-based government benefit programs" for which a supplemental benefits trust is intended to preserve eligibility are really "welfare" programs. The two most significant programs are SSI and the Medicaid program. It stands to reason that a person cannot be the beneficiary of a trust with hundreds of thousands of dollars of assets and still qualify for need-based benefits unless there are strings attached. Those strings limit the amount of "resources" that the beneficiary can own, and the amount of "income" that he or she can receive. Thus, while assets in a supplemental benefits trust are exempt from being counted when the beneficiary's eligibility is considered, how the trust assets are spent may well affect the beneficiary's eligibility. A supplemental benefits trust must be administered with constant consideration of those "resource" and "income" limitations.

1. <u>SSI Resource Limitations</u>

(a) Generally speaking, SSI allows a single beneficiary to have at any given time no more than $2,000 worth of "countable resources." However, there are certain resources that the beneficiary can have which are not counted in determining eligibility. Because SSI is a federal program, these "exempt resources" are summarized in the Code of Federal Regulations. 20 *C.F.R.* 416.1210 summarizes the resources that are not excluded. The most significant excluded resources are, at the present time:

(i) The home, if it is the beneficiary's "principal place of residence."

(ii) Household goods and personal effects. This includes household furniture, furnishings and equipment, which are commonly found in or about a home.

(iii) A vehicle.

(iv) Property of a trade or business, which is essential to the means of self-support, is excluded regardless of its value or rate of return.

(v) Non-business property which is essential to the means of self-support, up to $6,000.

(vi) Resources of a blind or disabled individual which are necessary to fulfill a written plan for achieving self-support that has been approved by the Social Security Administration, as provided in 20 *C.F.R.* 416.1226.

(vii) Life insurance owned by an individual (and spouse, if any) if the face value does not exceed $1,500. (If it does, the cash surrender value is counted as a resource).

(viii) Payments or benefits provided under a Federal statute other than Title XVI of the Social Security Act where exclusion is required by such statute.

(ix) Disaster relief assistance.

(x) Burial spaces and certain funds up to $1,500 for burial expenses.

(b) There are a number of other exempt resources (generally dealing with government benefits that are specifically exempted from being counted for SSI eligibility purposes, and special interests) that are so arcane that they will have little utility in the administration of most supplemental benefits trusts.

(c) Purchase by the supplemental benefits trust of a resource in the name of the beneficiary that is not exempt from being counted will adversely affect the beneficiary's eligibility. Even a countable resource of modest value, when added to the beneficiary's existing resources may adversely affect the beneficiary's eligibility. Therefore, every purchase of an asset must be considered carefully to determine its effect.

(d) Note that SSI considers the countable resources of a minor beneficiary's parents (if they are residing in the same household with the beneficiary) and a married beneficiary's spouse (but not a domestic partner) when determining eligibility (*i.e.*, the “deeming” of resources). Therefore, decisions about purchases of resources for minors or married beneficiaries (other than domestic partners) must consider the countable resources of other members of the family as well.

CHECKLIST FOR EVALUATING SSI RESOURCE LIMITATIONS

1. Determine whether the asset to be purchased is exempt from being counted by SSI.

2. If the asset is countable, consider whether the $2,000 resource limitation will be exceeded in light of the following:

   A. The other countable resources owned by the beneficiary.

   B. The other countable resources owned by the parents of a minor beneficiary if they are residing in the same household with the beneficiary.

   C. The other countable resources owned by the spouse of a married beneficiary.

2. State Medicaid Resource Limitations

(a) Planners should consult with a local attorney or the check the state Medicaid manual to determine the state Medicaid resource limitations.

(c) As with SSI, certain types of resources are exempt from being counted. Because the Medicaid programs are joint federal and state programs, the "exempt resources" can be no more restrictive than for SSI under federal law. Under most programs, the most significant excluded resources are, at the present time:

(i) The principal residence.

(ii) The proceeds from the sale of a home or other real property that are used to purchase another home.

(iii) Household goods and personal effects of minimal value.

(iv) A vehicle.

(v) Property of a trade or business which is essential to the means of self-support, up to $6,000.

(vi) Non-business property which is essential to the means of self-support, up to $6,000.

(vii) Life insurance owned by an individual (and spouse, if any) if the face value does not exceed $1,500. (If it does, the cash surrender value is counted as a resource).

(viii) Burial vaults, crypts and plots regardless of value, as long as they are intended to be used for the applicant or the applicant's family, valued up to $1,500.

(ix) Burial contracts, of a reasonable amount, if irrevocable.

(d) The same inquiry that is made with regard to SSI before buying an asset should be made with regard to the local Medicaid Program limitations.

(e) The state Medicaid program also may consider the countable resources of the parents (and the step-parents if living in the same household) of a minor beneficiary or the spouse of a married beneficiary. The state Medicaid program may consider the countable resources of a minor beneficiary's parents and a married beneficiary's spouse when determining eligibility. However, there are instances when only the minor beneficiary's countable resources may be considered, such as when the minor beneficiary does not live with his or her parents due to institutionalization, at which time the resources of the parents of the minor beneficiary are not counted. Decisions about purchases of resources for such beneficiaries must consider the countable resources of other members of the family as well.

(f) On February 8, 2006 the federal Deficit Reduction Act of 2005 ("DRA 2005") was signed into law. Chapter 2 of Title VI of the Act is entitled "Long-Term Care Under Medicaid"; Subchapter A of this Chapter is entitled "Reform of Asset Transfer Rules". This section makes significant changes to the rules under Medicaid for the treatment of asset transfers by applicants for Medicaid, the use of annuities and promissory notes for eligibility purposes, as well as limiting the value of home equity for eligibility purposes. The new Medicaid rules are designed to restrict individuals from arranging their financial affairs in order to retain the economic benefit of their wealth while, at the same time, securing government subsidized long-term custodial care services. This is accomplished in a variety of ways. For example, the law:

- Extends Medicaid's "look-back" period for all asset transfers from three to five years.
- Changes the start of the penalty period for transferred assets from the date of transfer to the date when the individual transferring the assets enters a long-term care facility and would otherwise be eligible for Medicaid coverage.

- Prohibits States from "rounding down" fractional periods of ineligibility when determining ineligibility periods resulting from asset transfers.
- Permits States to treat multiple transfers of assets as a single transfer and begin any penalty period on the earliest date that would apply to such transfers.
- Establishes new rules for the treatment of annuities, including a requirement that the state be named as the remainder beneficiary.
- Allows Continuing Care Retirement Communities to require residents to spend down their declared resources, including a resident's entrance fee, before applying for Medicaid.
- Requires all states to apply the so-called "income-first" rule to community spouses who appeal for an increased resource allowance based on their need for more funds invested to meet their minimum income requirements.
- Requires the purchase of a life estate to be included in the definition of "assets" unless the purchaser resides in the home for at least one year after the date of purchase.
- Mandates that funds loaned in exchange for a promissory note or mortgage be included among assets unless the repayment terms are actuarially sound; provide for equal payments and prohibits the cancellation of the balance upon the death of the lender.
- Renders any individual with home equity above $500,000 ineligible for Medicaid nursing home benefits, although states may raise this threshold as high as $750,000.

CHECKLIST FOR EVALUATING MEDICAID RESOURCE LIMITATIONS

1. Determine whether the applicable state Medicaid program counts resources.
2. If resources are counted, determine whether the asset to be purchased is exempt from being counted.
3. If the asset is countable, consider whether the resource limitation for Medicaid benefits will be exceeded in light of the following:

   A. The other countable resources owned by the beneficiary.

   B. The other countable resources owned by the parents (and spouses of parents) of a minor beneficiary.

   C. The other countable resources owned by the spouse of a married beneficiary.

3. <u>SSI Income Limitations</u>

(a) Types of Income. SSI consists of monthly payments to the beneficiary in amounts that vary from year to year and from State to State. The base amount of the payment is called the "Federal Benefit Rate," and is $698 in 2012. This amount usually changes every year according to the cost of living. Additionally, the states sometimes increase the base amount (which adjustment changes from year to year). The purpose of SSI is to provide money to meet a person's basic necessities for life, *i.e.*, food and shelter. Thus, "income" is defined as anything the beneficiary can receive in cash or in kind that can be used to meet his or her needs for food and shelter. (As of February 7, 2005, clothing is no longer counted as income. 70 *Fed. Reg*. 6340, 6345). Generally speaking, any "income" that the beneficiary receives will diminish the amount of the SSI payment. The effect of different types of income on the SSI benefits is summarized as follows:

(i) Earned Income

(A) Earned income consists of wages, net earnings from self-employment, refunds of federal income taxes, payments received for services performed in self-support workshops, and certain royalties and honoraria. There are a variety of types of "earned income" that are excluded, which generally come from federal welfare programs (*e.g.*, food stamps, school lunches, energy assistance payments and certain educational grants or loans). Additionally, $65 of earned income is automatically excluded every month, as is one half of the remaining earned income.

(B) In a nutshell, earned income will reduce the SSI payment by somewhat less than 50 cents for every dollar or earned income received.

(C) Payments from a supplemental benefits trust to a beneficiary are unearned income as described below. The amount of any other unearned income and the amount of any earned income received by the beneficiary must be ascertained and considered, because it is the sum of the beneficiary's unearned and earned income that is considered in determining SSI eligibility. In states that automatically qualify individuals for certain Medicaid programs because they receive SSI, it is important that payments from a testamentary or living supplemental benefits trust not disqualify the beneficiary from SSI.

(ii) Unearned Income

(i) Unearned income is all income that is not earned income. It consists of (among other things) annuities, pensions, other periodic payments, alimony and support payments, dividends, interest and certain royalties, rents, death benefits, prizes and awards, gifts and inheritances, and support and maintenance that is provided for the beneficiary.

(ii) Payments from a supplemental benefits trust to the beneficiary are unearned income. There are a variety of types of "unearned income" that are excluded from being counted, which are typically benefits from government programs. (These are set forth at 20 *C.F.R.* 416.1124.) Other significant exclusions from unearned income include (A) portions of grants, scholarships or fellowships used for paying tuition and other educational expenses; (B) 1/3 of child support payments received by a minor, and (C) $20 per month. After that, unearned income will reduce the SSI payment by 100 cents for every dollar of unearned income received.

(iii) In-Kind Income

(A) In-kind income is any "food or shelter" that is given to the beneficiary. "Shelter" is defined to include room, rent, mortgage payments, real property taxes, heating fuel, gas, electricity, water, sewerage and garbage collection services. Therefore, if the supplemental benefits trust pays the beneficiary's rent, or pays a portion of the cost of the beneficiary's food for a month, the trust is providing "in-kind income" to the beneficiary. The effect that such income will have on the beneficiary's eligibility is that the government will presume that the food or shelter provided is worth one-third of the SSI payment the beneficiary would otherwise be entitled to, plus $20. The beneficiary has the ability to prove to the government that the value of the food or shelter received is less than the presumed value.

(B) While it may appear beneficial to pay hundreds of dollars in a month for a beneficiary's food or shelter while only diminishing their SSI benefit by 1/3 of the Federal Benefit Rate, in-kind income can be added to other income received by the beneficiary and may result in disqualification. **Payments of in-kind income should be made only after full consideration of all other income being received by the beneficiary.**

(iv) Deemed Income. Just as SSI deems "resources" of a minor's parents and a married beneficiary's spouse (but not domestic partner) to be income of the beneficiary, it deems income as well. (Income received by a parent for providing in-home support services is not counted.) The process of "deeming" income is complex, and basically consists of three steps.

(a) Determining whether income from the parents or spouse (but not domestic partner) should be deemed at all.

(b) If there is deeming, determining whether the beneficiary continues to qualify for SSI.

(c) If there is deeming and if the beneficiary continues to qualify for SSI, what the amount of the SSI benefit will be.

(b) Conclusions Regarding the SSI Income Limitations. The actual rules are more complex than the brief summaries given above. Before decisions are made about making payments from a supplemental benefits trust that may be considered "income" of the beneficiary, information must be obtained about (a) the beneficiary's income from other sources than the supplemental benefits trust, and (b) the income of the beneficiary's parents or spouse (but not domestic partner).

J. Summary: A supplemental benefits trust can allow the disabled individual to live with greater dignity by covering supplemental needs not met through government, charitable or other benefits. Preparing a trust that is appropriate for a particular client requires that the elder and disability law practitioner understand the differences between the various special needs and supplemental benefits trusts available and the tax and government benefits planning ramifications of each. Only with such knowledge can the elder and disability law practitioner draft the documents required to meet the needs of his or her clients.

VI. FINDING A SPECIAL NEEDS ATTORNEY

1. Special Needs Alliance (SNA)- www.specialneedsalliance.org or 1-877-572-8472. Network of disability and public benefits attorneys by invitation only.

2. Academy of Special Needs Planners (ASNP)- www.specialneedsplanners.com or 1-866-267-0947.
   Network of disability and public benefits attorneys.

3. National Academy of Elder Law Attorneys (NAELA) – www.naela.org or 703-942-5711.
   Network of elder, disability and public benefits attorneys.

4. State, county and city bar associations.