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Special Needs Trusts for the Elderly and Individuals with Disabilities to Protect Public Benefits

Administering First- and Third-Party Trusts; Addressing the Interplay Between SNTs, Guardianships and Conservatorships

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Special Needs Trusts for the Elderly and Individuals with Disabilities to Protect Public Benefits

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Special Needs Trust Overview

- Special needs trust is established pursuant to 42 U.S.C. Section 1396p(d)(4)(A) or (C)
- Authorized by Congress to protect the income and medical benefits of a disabled individual
- The trust must strictly comply with the law to protect the beneficiary
- There are several types of special needs trusts
- The law controls depending on circumstance and age

Types of Special Needs Trusts

- 1st party trust
- 3rd party trust
- Pooled Trust
- Supplemental Trust
- Support Trust

First party trust

- Most common type, and also known as “self-settled”, this trust is funded by the beneficiary’s own funds or funds to which the beneficiary is entitled
- Must be established by a parent, grandparent, guardian or Court
- Now, after Special Needs Fairness Act, competent beneficiary may establish
- If incapacitated and no parent, grandparent, or guardian available, then you must request the Court to approve
- Medicaid and Social Security must also approve
- Commonly funded with personal injury settlements, inheritance

Third party trust

- Established with assets that do not belong to beneficiary
- No “payback provision” is required
- Must abide by same rules otherwise

Pooled trust

- Each state has one or more company that provides pooled trust services
- The trust is established through a more streamlined process and the "trustee" is really a co-trustee, at best, with the trust administrator
- Must use a pooled trust for those over 64 years of age
- Must have a payback provision

Supplemental vs. Support Trust

- Supplemental Trust “supplements” the beneficiary’s lifestyle
- Can pay for cable, cell phone, furniture, electronics, vacation, car, car insurance, funeral arrangements, etc.
- Does not pay for “support” items like food, shelter, medical care

Interested parties in SNT

- Settlor
- Trustee
- Beneficiary
- Guardian
- Court
- Social Security Administration
- Medicaid Agency

PUBLIC BENEFITS CONSIDERATIONS

- Goal in most is not to lose means tested benefits
- SSI vs. SSDI
- Medicaid benefits
- Lookback period
- Penalty
- Termination of benefits
- Payback and estate recovery

SSI vs. SSDI

- SSDI is not means tested benefits
- Caution! Those on SSDI may qualify for substantial discounts or Medicaid waiver or nursing home and will lose it if assets, income, rise
- SSDI otherwise does not need 1st party trust, use 3rd party trust
- All SSI must have 1st party trust
- All Medicaid must have 1st party trust

Medicaid benefits

- Caution! Those on SSDI may qualify for substantial discounts or Medicaid waiver or nursing home and will lose it if assets, income, rise
- There are many many different types of Medicaid so important to find out if the beneficiary receives any of them
- Ex: caregivers at home, QMB, SNP, Sobra, CHIP

Five Year Lookback Period

- Deficit Reduction Act of 2005 imposed a 5 year lookback period (effective for most states 2/8/2006)
- Restrictions on transfers of assets
- Established penalty period for transfers for less than fair market value
- Penalty Period is UNLIMITED
- Changed beginning point of penalty period
- This will affect nursing home benefits/Medicaid waiver
- SSI recipients not in need of those services will have 24 month benefit interruption

Penalty Period

- Will be imposed for transfers for less than fair market value after 2/8/2006
- Will not start running until applicant otherwise qualifies for Medicaid benefits

  --in a covered long term care facility

  --spent down financially

  --income qualified
- UNLIMITED

How the penalty is calculated

- Penalty may be imposed for even minimal transfers
- The amount of the penalty is calculated by adding up the transferred amounts and dividing by the average cost of nursing home care in the area or state as determined by the jurisdiction
- Can vary wildly by state

Cost of long term care relating to Penalty

- Can vary by state: may affect placement:

-- Mom transfers her home worth $100,000 to daughter in July 2013. She falls, hits her head, and enters a nursing home for long term care in July 2017. She spends her savings and is under $2000 and eligible in October, 2018. In Alabama, divisor is $6100, so penalty period ends March 2020 (a partial month) and in Florida, divisor is $8944 so penalty period is 11.18 months, she would have been eligible in October, 2019.

- No long term care costs as little as $6100.00 in Alabama

Cost of long term care relating to Penalty

- If you said apply in August, 2018, you win!!
- Remember the 5 year lookback, if you wait to apply until August 2017, then the 5 years has run…
- NO PENALTY
- If you apply in July of 2018, call your insurance carrier
- THE PROBLEM: Most nursing homes have your client sign a Medicaid application on admission and routinely file them
- Another solution, transfer funds into a SNT to cover the penalty (particularly if Mom has higher income), then apply earlier. So, if Mom had the money to pay the nursing home for several years, she can pay into SNT

Using SNT to pay off the Penalty

- Another solution, transfer funds into a SNT to cover the penalty (particularly if Mom has higher income), then apply earlier. So, if Mom had the money to pay the nursing home for several months, she can pay into SNT*
- Mom enters nursing home in July 2018, has $40,000.00, buys burial for $10,000.00, pays nursing home July, August, September, qualifies October, 2018
- OR transfer $40,000.00 into SNT and pay a penalty period (the difference between the Medicaid cost of NH and her income, for 16 months. So if her income is $4,000.00, she will pay about $56,000.00, so the recipient got the $100,000.00 house for $16,000.00
- Note the lower her income the more you will pay

*But some states will penalize the transfer to the SNT so be cautious

- Alabama is one of ___ states that will not penalize the transfer to a special needs trust for a person over the age of 64. See e.g., Richardson v. Hamilton (D. Me., 2:17-cv-00134-JAW, Feb. 27, 2018)(Maine dismissed challenge)
- These states penalize: AZ, GA, HI, LA, ME, MS, NC, ND, NH, NJ, NM, NV, PA, SC, SD, TX, UT, VA, VT, WA, WY.
- These states say “it depends”: CO, IL, KS, MI, MN, MO, NE, NY, OR
- Must transfer to a pooled trust
- For higher income earners, may still be viable, but will need to provide more to cover the amount transferred to the special needs trust.
- If you are facing a penalty for SNT, may want to consider a direct gift

Payback provision and estate recovery

- A first party or pooled trust must have payback provision to reimburse Medicaid at death
- The moment of death, the payback kicks in (if you are going to pay for funeral…pay for it now!)
- After death, if Medicaid is owed anything, they will come after estate assets
- Many states have a law that states the estate lawyer must notify Medicaid upon opening the estate

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Special Needs Trusts: Drafting Considerations and Pitfalls to Avoid

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GENERAL TRUST REQUIREMENTS

- Supplement, not supplant, government benefits

Self-Settled Special Needs Trust

- 42 U.S.C. §1396p(d)(4)(A)
- Established with assets of individual with disabilities
- Individual must be under 65 at time of the establishment and funding BUT
  - SSA says payments from structured settlement beginning before age 65 and continuing thereafter are ok
- Individual must be disabled as defined in Social Security Act

SOCIAL SECURITY ACT DEFINITION OF "DISABLED"

"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"

DEFINITION OF DISABLED FOR CHILD UNDER 18

Child “suffers from any medically determinable physical or mental impairment of comparable severity” to adult

ADDITIONAL REQUIREMENTS OF PAYBACK TRUSTS

- Trust may be established by
  - Parent or
  - Grandparent or
  - Legal guardian or
  - Court or
  - Competent individual with disabilities

Self-Settled Special Needs Trust

- Certain regions require the trust of a competent beneficiary to be “seeded.”
- The parent or grandparent nominally funds the trust and then the assets of the beneficiary with disabilities are transferred to the trust.

PAYBACK REQUIREMENTS

- Medicaid agency entitled to reimbursement from any assets remaining in trust upon death of beneficiary or trust termination for other reasons
- Reimbursement “dollar for dollar” up to amount paid by Medicaid on behalf of individual
- Irrevocable

Trust Protector

Ensures that trustee is acting properly

May have power:

to receive account statements

to remove and replace trustee

May include additional powers of trust protector

Consider: Is trust protector a fiduciary? Compensation?

Self-Settled Special Needs Trust

- Check state requirements for additional drafting provisions

THIRD PARTY SPECIAL NEEDS TRUST

- Living trust or
- Testamentary trust created by will
- Revocable or
- Irrevocable

THIRD PARTY SPECIAL NEEDS TRUST

- Trust provisions need not be as restrictive as those in self-settled special needs trusts

Drafting Considerations for All SNTs

- Beneficiary cannot compel or control distributions
- Trustee has unfettered discretion
  - Authorize trustee to make distributions that may reduce or eliminate public benefits
  - Authorize trustee to amend trust to comply with current public benefits laws

Drafting Considerations for All SNTs

- Grantor or Non-Grantor Trust?
- Trustee compensation
- Accountings
- Successor and Substitute Trustees
- Trustee Powers
- Ultimate Beneficiaries

SPECIAL NEEDS TRUSTS AND TAXES

Review of the Basics:

Tax Brackets

Taxable Income vs. Benefits Income

Distributable Net Income

Deductible Expenses

Qualified Disability Trusts (QDTs)

Qualified Retirement Plans

Requirements for Trust to be Designated Beneficiary

Conduit vs. Accumulation Provisions

Remainder Beneficiaries

Crummey Powers vs. Cristofani Powers

Tax Brackets

Trusts reach the highest bracket of 37% with taxable income in excess of $12,750 (for 2019).

A single Individual reaches the highest bracket of 37% with taxable income in excess of $510,300 (for 2019).

Distributable Net Income

- reported as income and deductions by the beneficiary. Is the amount distributed to the beneficiary;
- Is calculated by taking the income earned by the trust, deducting the expenses = the net income after expenses: that is the DNI;
- DNI = is carried out to the beneficiary;
- For SNTs, the beneficiary only needs to report the DNI that was actually paid to the beneficiary;
- Taxable capital gains are also retained by and taxed to the trust
- Reported via a Form K-1 (to let the beneficiary know what must be reported as income and deductions on the beneficiary's individual return)

Complex vs. Simple Trusts

Simple trusts are required to distribute net income and are allotted a $300 exemption;

Complex trusts are not required to distribute net income and are allotted a $100 exemption.

Special Needs Trusts are always COMPLEX Trusts because they are not required to distribute net income.

A 3rd party SNT with at least $100 of income MUST file an income tax return.

Form 56 (Notice Concerning Fiduciary Relationship)

3.8% Net Investment Tax

Taxes on certain net investment income of individuals, estates, and trusts that have income above the statutory threshold amounts.

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widow(er) with dependent child	$250,000

Deductible Expenses

Medical Expenses – dental, drugs, medicines, nursing and attendant care, certain transportation and travel required for medical care, hearing aids, prosthetic devices, specially outfitted automobiles, tuition at a special program to educate students with neurological disorders, and residential modifications prescribed by doctors.

Administrative Expenses – accounting fees, tax preparation fees, attorney fees, fiduciary compensation fees.

Investment advisory fees – NO LONGER DEDUCTIBLE.

Qualified Disability Trusts

A Qualified Disability Trust is allowed a $4,200 exemption. This amount is not subject to phaseout.

Qualified Disability Trusts

A Qualified Disability Trust:

- The trust must be irrevocable;
- The trust must be established for the sole benefit of the disabled beneficiary;
- The disabled beneficiary must be under the age of 65 at the time the trust is established; and
- The beneficiary must have a disability that is included in the definition of disabled pursuant to the Social Security Act.

SNTs & Qualified Retirement Plans

THE GOAL is to stretch the taxability of the qualified plan distributions over the life of the beneficiary;

SNT as Designated Beneficiary

SNT as Designated Beneficiary of Qualified Retirement Plan:

1. The trust must be valid under state law;
2. The trust is irrevocable or it becomes irrevocable upon death;
3. The beneficiaries of the trust are identifiable;
4. The trust documentation has been provided by the trustee of the trust to the IRA custodian (or plan administrator) no later than October 31st of the year following the year of the IRA owner's death.

SNT as Designated Beneficiary

In addition, all trust beneficiaries must be individuals or there will be no designated beneficiary on the IRA and the stretch option will be lost.

If any one of the trust beneficiaries is not a person (for example, an estate or charity), then the IRA may not have a designated beneficiary and the stretch could be lost.

Conduit vs. Accumulation Provisions

Depends on how much post-death control the client wants the trustee to have over the IRA distributions paid to the trust, and ultimately to the beneficiaries of the trust.

Conduit Trust Provisions

Post-death annual RMDs flow through the trust to the trust beneficiaries. No IRA funds are retained in the trust. This eliminates any income tax at trust tax rates.

Post-death annual RMDs are based on the age of the oldest beneficiary of the trust but only primary beneficiaries are counted; remainder beneficiaries are not considered.

Accumulation Trust Provisions

Trustee has discretion – Trustee does NOT have to pay out all IRA distributions to the trust beneficiary. The Trustee is given discretion to either pay out some, all, or none of the IRA distributions to the trust's beneficiaries.

Distributions from the inherited IRA to the trust that are not paid out to the beneficiaries of the trust (retained in the trust) will be subject to income tax at the trust tax rates. Distributions from inherited Roth IRAs will generally be tax free.

Remainder Beneficiaries

Don’t get the benefit of the stretch, but receive 100% ordinary income.

Caveat for married couples, plan owner designates spouse as primary beneficiary, spouse then just continues taking distributions from the plan owner’s account. If the child’s special needs trust is the secondary beneficiary, then the special needs trust will not be a designated beneficiary and will not be able to take advantage of the stretch.

Remainder Beneficiaries

<u>Planning mistakes</u>:

Designating the estate or revocable living trust as beneficiary and losing the stretch;

Designating "my children in equal shares" rather than naming each child individually and designating each child's share outright or to a trust;

Failing to consider leaving other assets to the SNT (those without income tax liability)

Failing to make any designation!

Crummey vs. Cristofani Powers

Crummey powers allow trust beneficiaries a specific limited period of time to withdraw contributions made to the trust.

If an individual receiving SSI or Medicaid is granted Crummey powers, then the public benefits programs will treat the beneficiary's failure to exercise the withdrawal right either as a transfer of resources without consideration, or as income in the month the contribution is made to the trust, and as a resource the following month.

Crummey vs. Cristofani Powers

If the trust grantor has other children or family members who are beneficiaries at the death of the Grantor, then the Crummey power can be granted to all of those beneficiaries except the special needs trust. If needed to cover the full premium payment, the lifetime exemption may be applied instead. This works to leverage the exemption.

Cristofani powers: allows contingent beneficiaries to exercise withdrawal rights.

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