

## **SUPPLEMENTAL NEEDS TRUSTS**

### **What SNTs Can and Cannot Do for Your Client**

The primary purpose for the use of a Special Needs Trust is to maintain the eligibility of a disabled individual-beneficiary for governmental benefits. That is, the governmental agencies will be the primary source of support for the disabled individual-beneficiary (i.e. medical needs, food, and shelter), and distributions from the trust will be used to supplement that support. “Supplement” in this situation means to pay for extras that governmental benefits do not cover. This covers a wide range of products and services. However, a trustee must always keep in mind that distributions are to supplement government benefits and not provide support to the disabled individual-beneficiary or an inadvertent reduction or loss of government benefits will occur.

The governmental assistance that Special Needs Trusts permit, is itself typically divided into two (2) categories: first, entitlement programs that are funded by premiums paid into the system (Federal Insurance Contribution Act; FICA) and then distributed without regard to the assets owned by the recipients, such as Social Security, Social Security Disability (SSDI), and Medicare; second, means-tested programs for those persons who qualify and may or may not have paid into the program, such as Supplemental Security Income (SSI) and Medicaid. In Indiana, to be a recipient of Medicaid, a single individual must have less than \$1,500 (married = \$2,250) of assets, and to qualify for SSI benefits, less than \$2,000 (married = \$3,000) of assets; in either case, very little income is allowed to be available to the beneficiary net of the required “spend down.” A Special Needs Trust may allow the beneficiary to qualify for the means-tested governmental assistance even though the trust has been funded with far more than \$1,500 worth of assets. Funding may include gifts, inheritance, personal injury settlements, retroactive SSI payments, and any other assets or resources that are owned by the disabled individual.

The Self-Settled Special Needs Trusts, discussed in more detail below, permit a disabled individual-beneficiary to transfer his/her assets above the applicable limit without fear of a penalty period or large spend down. The resources transferred into this type of trust are considered exempt under law and are not subject to the look back period under Medicaid transfer of assets rules. Also, once the transfer is made, the trust corpus is not counted as a resource available to the disabled individual-beneficiary. Distributions from these trusts made for the benefit of the disabled individual-beneficiary are also not attributed to the disabled individual-beneficiary as income. 405 IAC 2-3-22(i).

Special Needs Trusts are not to be used as a bank account that can be drawn upon at the discretion of the disabled individual-beneficiary. This will surely result in the loss of governmental benefits. Furthermore, this type of trust does not provide the daily support for a disabled individual-beneficiary. A properly drafted support trust containing language advising the trustee to use the trust assets for the “health, education, maintenance, and support” of the disabled individual-beneficiary may be appropriate for the client(s) that intend to provide for food, shelter, and medical care for that individual. However, this type of trust will be deemed as an available resource by governmental agencies. Thus, the disabled individual-beneficiary of that type of trust will likely not qualify for governmental benefits.

#### Assessing the Degree of the Beneficiary’s Current and Future Disability and Needs

Special Needs Trusts are only a component of special needs planning with client(s). There are several factors to consider when meeting with the client(s) to plan for an individual with disabilities. The first aspect a lawyer should consider is the medical needs of the disabled individual. The lawyer should inquire about the medical diagnosis and its method of treatment. The lawyer should also know the limitations associated with the diagnosis as well as the disabled individuals strengths. What is the disabled individual’s prognosis? In addition, the need for medical equipment and required

prescription drugs should also be discussed. The lawyer should also discuss the means of financing the necessary medical care.

A second aspect to consider is the living arrangements for the disabled individual. Can the disabled individual live independently? The lawyer should discuss the costs involved in furnishing and maintaining a home or apartment for the disabled individual. The disabled individual may be able to live on his own but may need some assistance. The clients and the lawyer should assess how much assistance is appropriate for the situation and the ability of the individual to perform the activities of daily living (ADLs). This may range from someone coming into the home several times a week to the necessity of a live-in caregiver. The lawyer should discuss the possibility of the disabled individual living with a family member. Another alternative may be a residential group home. In some situations, an intermediate care facility or, in more serious circumstances, institutional care or skilled nursing facilities are more appropriate.

Another component to be considered during special needs planning is the education of the disabled individual. The lawyer should discuss the educational opportunities available to the individual in the community. It may be necessary for the disabled individual to be evaluated by a professional. An important inquiry within this component is the capability of the disabled individual being mainstreamed into the school system. If this is a possibility, it is important to consider how an individual education plan (IEP) will be implemented. On the other hand, the individual may benefit more from a special education school district. This option may entail more expenses but the individual will receive an education more conducive to his learning capabilities. It is also important to consider the possibility of the individual attending college.

An additional component to account for while engaged in special needs planning is the ability, if at all, for employment. If the individual is employable, it is important to note any special accommodations, in order to comply with the Americans with Disabilities Act, that an employer would need to make. A lawyer should also realize that employment might give the disabled individual a sense of fulfillment and an opportunity

for social interaction. Most importantly, the lawyer should know if the disabled individual is employable because the income that is produced by this individual may interfere with governmental benefits. Traditional Medicaid might not be an option and it may be necessary for the attorney to research other programs such as Med Works.

It is important to note that special needs planning is long-term planning. You are planning for the future of a disabled individual after parents or other family members have passed away. It is necessary to anticipate changes in the medical condition, expenses, etc., of the disabled individual and incorporate this into your planning. An additional concern that should be discussed during the client meeting is the standard of living that is desired for the disabled individual and how to finance it. While there may not be a need for governmental benefits while parents are living, this will likely change upon the passing of one or both parents. Also, parents may consider applying for governmental benefits now and placing money and other assets they would have spent for the benefit of the disabled individual into a Special Needs Trust that would provide for that individual after they pass away. The lawyer should also inquire if the disabled individual currently receives governmental benefits and what types. There may be additional resources available to the disabled individual that the parents were not aware of or that can be planned for once that individual meets the required criteria. The assistance of a life care planner or organization that focuses on the disabled will be able to assist you and your client(s) in this process.

### Types of SNTs and Their Uses

The Special Needs Trust, also known as a Supplemental Needs Trust, provides for a disabled individual's special needs without putting at risk his or her eligibility for governmental assistance. The definition of disability for Self-Settled Special Needs Trusts is the same definition that is found in the Social Security Act, which provides:

An individual shall be considered disabled . . . 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. 42 U.S.C. § 1382c(a)(3)(A).

Special Needs Trusts fall into two (2) main categories: Third-Party Special Needs Trusts and Self-Settled Special Needs Trusts, both of which are discussed below. However, all Special Needs Trusts are designed to permit the beneficiary to receive governmental assistance no matter how large the principal or the income of those trusts.

In all Special Needs Trusts, the language in the document should specifically state the special, limited purpose of the trust, which is, again, to supplement the governmental benefits the disabled individual receives, not put them at risk. Also, the trust should state that the trust assets are to be used for the sole benefit of the disabled individual-beneficiary. Thus, income should be distributed directly to third parties to pay for goods or services for the disabled individual-beneficiary. Income distributed to the disabled individual-beneficiary may jeopardize the governmental assistance received by the same individual. It is also important that the trust dictate that the trustee has sole discretion as to any distribution made for the benefit of the disabled individual. Furthermore, the trust must be irrevocable and cannot be altered by the disabled individual, although it can be changed by the court.

As mentioned above, Special Needs Trusts fall into two (2) categories. The first category is the Third-Party Special Needs Trust. These Special Needs Trusts can be created by any third party with the assets of that third party for the benefit of a disabled individual. It is important that the disabled individual-beneficiary's assets are not commingled with the assets of the trust. Children or other relatives of the disabled individual-beneficiary could create the trust. Furthermore, the disabled individual-beneficiary receiving benefits under this trust can be over the age of sixty-five (65) at the time the trust is established and funded. (Compare with 42 U.S.C 1396p (d)(4)(A).) Distributions from this type of trust will not affect the disabled individual-beneficiary's eligibility for Medicaid or other governmental benefits so long as, the trustee has absolute discretion to distribute the assets, the disabled individual is not the trustee, and the trust contains language that the distributions are to "supplement" but not "supplant" any

governmental benefits the disabled individual-beneficiary may be receiving. There is no requirement that Medicaid be reimbursed from this type of trust upon the death of the disabled individual-beneficiary. These trusts are controlled by the common law of the state where they are created. (A good starting point is Indiana Code § 12-15, Indiana Administrative Code Title 405, and the Indiana Client Eligibility System [ICES] Manual.)

The second category is Self-Settled Special Needs Trusts. Self-Settled Special Needs Trusts are controlled by the Omnibus Budget Reconciliation Act of 1993 “OBRA’93”. There are also two (2) types of Self-Settled Special Needs Trusts under OBRA’93.

The first type of Self-Settled Special Needs Trust is referred to as a Free-Standing OBRA’93 Pay Back (d)(4)(A) Trust. It exempts transfers of the disabled individual’s assets made to a trust that is created for the benefit of that individual by a parent, grandparent, legal guardian, or court. The disabled individual must be under the age of 65 at the time the trust is created and must be the sole beneficiary under the trust. This trust must be irrevocable, and no assets can be added after the beneficiary attains the age of 65. Also, there is no restriction on the selection of a trustee. This trust must provide for the repayment to the state of benefits paid to the disabled individual-beneficiary pursuant to the state’s Medicaid plan. The maximum amount of reimbursement is equal to the total assistance paid on behalf of the disabled individual; no interest is charged on the reimbursement.

Someone other than the disabled individual must be the creator of an OBRA ‘93 (d)(4)(A) trust. Here, only a parent, grandparent, legal guardian, or the court may be considered the creator of this type of Special Needs Trust. SSI rules require that the creator of the Special Needs Trust have legal authority to act with regard to the assets of the disabled individual or the trust is deemed invalid. A petition can be filed with a court of general jurisdiction requesting the creation and establishment of the Special Needs Trust without establishing a guardianship prior. Indiana permits Protective Proceedings

to assist in handling a disabled individual's affairs. [I.C. §§29-3-4-1 to 29-3-4-4]. A Protective Proceeding is for a single issue and transaction, rather than a guardianship that is continual. These Protective Proceedings are a good approach for the approval of the creation of a Special Needs Trust, when court approval is warranted.

Contrarily, the second type of Self-Settled Special Needs Trust, the OBRA '93 Pooled Pay Back (d)(4)(C) Trust allows a disabled individual to be over the age of 65 at the time of creation and additional assets can be added at any time. Indiana (and Illinois) is not a state that penalizes transfers to this kind of trust by a disabled individual over the age of 65. This type of trust can be funded with the assets of a third party or the disabled individual. It also permits the disabled individual to create the trust himself or a parent, grandparent, legal guardian, or court may create the trust. This type of Special Needs Trust is established and managed by a non-profit organization that acts as trustee. Each disabled-individual beneficiary has a separate account, with its own EIN number, governed by a Master Trust Agreement. The non-profit organization typically requires completion of a joinder agreement and payment of fees prior to enrollment and, thereafter, annual management fees. The non-profit organization, with the help of a financial institution, pools the funds from each individual account for investment purposes. The trust must contain language that states upon the death of the disabled individual-beneficiary, any assets left in the account that are not retained by the trust, the trust reimburses to the state the amount equal to the total amount of medical assistance paid under Medicaid.

On a side note, there is also a *Miller*-Type or Qualified Income Trust (QIT) that is used to maintain Medicaid eligibility, particularly for waiver services, for a disabled individual-beneficiary. (See *Miller v. Ibarra*, 746 F. Supp. 19 (D. Col. 1990).) This trust, also recognized in OBRA '93, is composed only of pension, Social Security, and/or other income to the individual, including accumulated interest that exceeds the Special Income Limit for these types of services (42 U.S.C. §1396p(d)(4)(B)). However, no resources may be used to establish or augment the trust or the trust will lose its exemption for transfer of assets purposes. Similar to the trusts previously discussed, this trust must

also be irrevocable. The trust must include a provision stating that upon the death of the disabled individual-beneficiary, the state receives all amounts remaining in the trust up to the amount equal to the total medical assistance paid under Medicaid. Often there are little or no funds remaining in the trust at that time.

### Basic Drafting Considerations

The key to a properly drafted Special Needs Trust is the unavailability of the trust's assets to the disabled individual-beneficiary. If the assets in the trust are determined to be available to the disabled individual-beneficiary by a governmental agency, then he/she becomes ineligible for these types of benefits. There are three (3) aspects to consider when drafting a Special Needs Trust that is unavailable to the disabled individual-beneficiary, they are: (1) the ability of the disabled individual-beneficiary to revoke the trust; (2) the ability of the disabled individual-beneficiary to compel distributions from the trust; and (3) the trustee's discretion.

When drafting a Special Needs Trust it is important to include a provision in the document that the disabled individual-beneficiary cannot revoke the trust. If the trust contains any language that indicates that the disabled individual-beneficiary has the right to revoke the trust, and, thereafter, transfer trust assets to him/herself, a governmental agency will deem it to be an available asset and eligibility for government benefits will be lost. As discussed above, an OBRA '93 (d)(4)(A) and (d)(4)(C) trusts must be drafted as an irrevocable trust. It is important to note that although a trust may be a pooled trust, it may not qualify as an OBRA '93 (d)(4)(C) trust. Be sure to research the pooled trust organization thoroughly to ensure that the trust is, in fact, an OBRA '93 (d)(4)(C) qualifying trust.

Also, the disabled individual-beneficiary should not have the right to compel a distribution to be made from the trust. Therefore, language stating that distributions for food, shelter, and clothing may be made for the support and maintenance of the disabled individual-beneficiary must not be included in a Special Needs Trust. Distributions made pursuant to this language will be deemed in-kind support and maintenance and will cause

a reduction of the disabled individual-beneficiary's governmental benefits. It is also advisable to include a valid spendthrift provision within the Special Needs Trust. This will prevent the disabled individual-beneficiary from transferring any part of his/her interest in the trust to creditors.

The discretion given to the trustee of a Special Needs Trust is also a critical factor when government agencies determine eligibility for benefits. Assets held in a purely discretionary trust, that is, one that gives the trustee absolute discretion with regard to the payment of income and/or principal, will not be considered in determining eligibility for governmental benefits. Using language such as, "sole, absolute, and unfettered discretion," will convey that the trustee has the discretion to make or not make distributions from the trust for the benefit of the disabled individual-beneficiary. This language further illustrates the lack of control that the disabled individual-beneficiary has over the trust's assets and further suggests the trust's unavailability.

When drafting a Special Needs Trust, it is also important to consider the applicable transfer of assets rules in connection with funding the trust. For Medicaid eligibility purposes, a trust established by the Medicaid recipient or applicant is reviewed in conjunction with 405 IAC 2-3-22. The assets held in a revocable trust established by an applicant or recipient of Medicaid are considered assets available to the individual for eligibility purposes. 405 IAC 2-3-22(b)(1). Payments made from a revocable trust to or for the benefit of the individual are considered income to the individual. 405 IAC 2-3-22(b)(2).

Except for OBRA '93 (d)(4)(A) and (d)(4)(C) Special Needs Trusts, the assets of an irrevocable trust established by a Medicaid recipient or applicant where there are circumstances under which payment from the trust could be made to or for the benefit of the individual are considered assets available to that individual. 405 IAC 2-3-22(i); 405 IAC 2-3-22(c)(1). Payments made to or for the benefit of the individual are considered income of the individual. 405 IAC 2-3-22(c)(1)(A). Assets of an irrevocable trust where there are no circumstances under which payment from the trust can be made to or for the

benefit of the individual are considered assets disposed of by the individual as of the date the trust was established. 405 IAC 2-3-22(c)(2)(A). Third-Party Special Needs Trusts are reviewed for the purposes of determining the availability of the trust to the disabled individual-beneficiary for eligibility purposes. ICES 2615.75.20.10.

An additional provision that is essential to a properly drafted Special Needs Trust is the Medicaid payback provision. This type of provision only appears in OBRA '93 (d)(4)(A) and (d)(4)(C) Special Needs Trusts. When drafting the Medicaid payback provision for an OBRA '93 (d)(4)(A) Special Needs Trust, it is best to follow the language of 405 IAC (i)(2)(D) and ICES 2615.75.20.05. This will only help your client(s) when a governmental agency reviews the Special Needs Trust when determining eligibility for benefits. 405 IAC (i)(2)(D) contains appropriate language for use in an OBRA '93 (d)(4)(A) Special Needs Trust, asserting that "...the state will receive all amounts remaining in the trust upon the death of the individual up to an amount equal to the total medical assistance paid on behalf of the individual." When reviewing the Master Trust instrument for an OBRA '93 (d)(4)(C), it is important that the trust contain language that conforms with 405 IAC (i)(3)(D), which states, "that to the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the state from the remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary." A Medicaid payback provision is not a requirement of a Third-Party Special Needs Trust. Including a Medicaid payback provision within a Third-Party Special Needs Trust establishes a payment obligation that did not exist without this provision and can be cause for a legal malpractice claim.

### SNT Funding, Administration, and Termination

#### Funding the SNT

After assessing the current and future needs of the disabled individual with your client(s), the lawyer should discuss with the client(s) funding the Third-Party Special

Needs Trust. The client(s) might be surprised to learn that his intention of equally dividing his estate among all of his children will leave the Third-Party Special Needs Trust insufficient to assist the disabled individual-beneficiary. It is advisable to keep in mind that every client's situation is different and that there are a multitude of factors to consider. The most important factor is the availability of governmental benefits. It is important to convey to the client(s) that the existence of these benefits is not guaranteed. One approach may be to discuss the investment and financing possibilities with a financial advisor who has been trained in Special Needs Trusts. Another possibility is to establish an irrevocable life insurance trust (ILIT) that names the Third-Party Special Needs Trust as the beneficiary. A Third-Party Special Needs Trust can also be funded with retirement account assets. The beneficiary designation form would simply name the trust as the beneficiary.

Self-Settled Special Needs Trusts (OBRA '93 (d)(4)(A) and (d)(4)(C)) differ from third-party trusts because, of course, they are funded with the disabled individual-beneficiary's own assets. This may be in the form of a monetary judgment due to a personal injury action, or an inheritance received from a family member, or any other type of asset that the disabled individual-beneficiary may own. Similar to the Third-Party Special Needs Trust, a trustee might find it desirable to consult with a financial advisor regarding the investment of these assets for an OBRA '93 (d)(4)(A) trust. The OBRA '93 (d)(4)(C) pooled trust will generally accept only cash assets. It is also important to note that some OBRA '93 (d)(4)(C) pooled trusts have a minimum cash limit requirement in order to join the trust. (Some minimum limits can be quite large, while others can be as low as \$10,000.)

#### Administration of the SNT

The administration of a Special Needs Trust is incredibly complex and requires knowledge of governmental benefits rules and regulations, tax law, and the numerous duties required of a trustee. Despite this, the client(s) may prefer a family member to act as trustee for a Special Needs Trust (Third-Party or OBRA '93 (d)(4)(A)). It is best to advise the client(s) to name a non-interested party, such as a corporate trust department

with experience in administering these types of trusts, or a disability related non-profit organization, as trustee. They may want to name the desired family member as co-trustee along with the corporate trustee.

The trustee of a Special Needs Trust has the same duties as any trustee. These duties are found within the trust document itself or state law (IC § 30-4). These duties include the duty of loyalty, to administer the trust, invest the trust assets, recordkeeping, etc. The trustee has absolute and unfettered discretion to make or not make any distributions from the trust. This is, of course, to maintain the eligibility of the disabled individual-beneficiary for governmental benefits. When distributions are made, they must be for the sole benefit of the disabled individual-beneficiary. If a distribution is made that benefits another person, that person will have to pay his pro rata share. (For example, if the family home is purchased by the Special Needs Trust, other family members who reside there must pay their pro rata share of the home's expenses.) The distributions will be made directly to the provider of goods and services so as to not be counted as income attributable to the disabled individual-beneficiary. The trustee must also be aware that distributions for food and shelter may be deemed in-kind support and maintenance and also disqualify or minimize governmental benefits.

The administration of an OBRA '93 (d)(4)(C) pooled trust is generally provided by a disability related non-profit organization. The person who is establishing the trust, i.e., parent, grandparent, disabled individual-beneficiary, etc., completes a joinder agreement to join the Master Trust and establish the separate account as discussed above. The trustee then becomes responsible for the daily management of the separate accounts pursuant to the Master Trust Agreement and the disabled individual-beneficiary's joinder agreement. This includes handling requests for distributions, making said distributions that maintain eligibility for governmental benefits, investing the assets of the pool (usually with the advice of a banking institution), and preparing accountings and tax returns and other necessary reports for the trust. Pooled trusts do charge fees for these services. Generally, a joinder fee is charged when the separate account is created. There is also an annual fee for maintaining and investing the assets in the separate account that

is a percentage of the amount in the account. Distribution requests are commonly made in writing or by completing a form prepared by the pooled trust.

#### Termination of the SNT

A Third-Party Special Needs Trust may terminate upon the death of the disabled individual-beneficiary. However, there may be cases where your client(s) believe that there is a possibility of recovery for the disabled individual-beneficiary. In those circumstances, it may be appropriate to provide within the trust document specific criteria that needs to be met in order for the trust to terminate (for example, indicators of financial independence, attending physician reports, etc.) It is important to draft flexibility into the trust document so that the disabled individual-beneficiary may still receive distributions from the trust even if governmental benefits are no longer being received. The flexibility drafted in a Third-Party Special Needs Trust is possible because the disabled individual-beneficiary under this trust does not have to meet Social Security's definition of "disabled." Also, governmental entities review a Third-Party Special Trust for its availability to the beneficiary; not for the criteria set forth in OBRA '93. You may also want to give the trustee discretion to terminate the Third-Party Special Needs Trust and make distributions to alternate beneficiaries in the event Medicaid determines that the trust is available to the disabled individual-beneficiary. A Third-Party Special Needs Trust may name remainder beneficiaries who receive distributions from the trust upon the death of the disabled individual-beneficiary. Most importantly, do not include a payback provision upon the termination of a third-party special needs trust. The payback provision is only required in the OBRA '93 trusts and including such a provision in a Third-Party Special Needs Trust creates a payment obligation that did not previously exist. It is also cause for a malpractice claim.

The most likely termination of an OBRA '93 (d)(4)(A) and (d)(4)(C) pooled trust is the death of the disabled individual-beneficiary. There may be the rare situation where the disabled individual-beneficiary is restored to capacity and is no longer disabled under the Social Security definition. In that situation, the restored beneficiary would direct the disposition of any assets remaining in the trust after payback. Termination provisions are

not recommended for OBRA '93 (d)(4)(A) trusts as governmental agencies may not deem the trust to be in existence for the sole benefit of the disabled individual-beneficiary and consider it an available asset if the provision provides for payment to a third party after payback. Pursuant to § 1396p(d)(4)(A) and (d)(4)(C), upon the death of the disabled individual-beneficiary, the state's Medicaid agency must be reimbursed to the extent that the agency provided assistance to that disabled individual-beneficiary. The Master Trust Agreement of an OBRA '93 (d)(4)(C) pooled trust may provide for pro rata payment of its fees and services and/or retain for its charitable purpose any remaining amounts in a disabled individual-beneficiary's separate account if said amounts are not used to reimburse the state's Medicaid agency. Every OBRA '93 (d)(4)(C) Master Trust agreement is unique, and thus, it is important to review the document carefully so that you can convey to your client(s) how any remaining funds in the disabled individual-beneficiary's account will be distributed upon his/her death.