SPECIAL NEEDS TRUSTS:
Enhancing Quality of Life and Preserving Eligibility for Government Benefits

By David J. Gordon, CFP®, CIMA®, and Kirsten H. Gordon, CFP®

The special or supplemental needs trust (SNT) is a statutory creation used primarily to protect and optimize the financial planning opportunities of people with physical or mental disabilities. SNT users are persons who otherwise would meet the Social Security general assistance aid requirements but for their often-meager level of wealth or income. This article discusses trusts created under the Omnibus Budget and Reconciliation Act of 1993 (OBRA) and codified in 42 U.S.C. 1396p(d)(4)(A), et. seq., and Third-Party Trusts. SNTs also may be referred to as “OBRA 93 Trusts,” “d4A” or “d4C” trusts, and Third-Party Trusts. In Illinois, relevant statutory authority is found at 760 ILCS 5/15.1; 305 ILS 5/5—1.1a, 405ILCS 5/5-105, and 89 Ill. Admin. Code Sect.120.347.

Introduction

Special needs trusts (SNTs) are an important exception to the rules that typically apply to most trusts. Established for the benefit of special needs individuals, properly designed and implemented SNTs can shelter assets from needs-based programs such as Medicaid and Supplemental Security Income (SSI). Moreover, for people under age 65, an SNT will not be subject to the “look-back” rules. These rules, designed to prevent gratuitous transfers for the sole purpose of aid qualification, consider “available resources” to include those transferred within 36 months for transfers to individuals, and five years for transfers to trusts.

Applications for most needs-based public assistance consider the typical trust as an available resource. This is not the case with SNTs, which are specifically exempt from being considered an available resource. At the death of the beneficiary, the public agency usually will place a lien against the trust to recover funds provided. However, while alive, the beneficiary will have the added security and flexibility of available trust assets to supplement quality of life and care.

Needs-based programs generally are subject to asset and income thresholds that can disqualify or require contribution from those with even very modest financial resources. These types of programs form a long list, and may include food stamps, Veterans Administration benefits, Medicare Part D, state and county benefits, legal and health clinics, and services or financial aid from other public or private organizations. They are distinguished from entitlement programs such as Medicare and Social Security Disability Insurance (SSDI), where qualification requires only requisite work-related tenure of the recipient or parent.

Three Basic Formats

There are three main types of SNTs (see table 1). They feature different funding sources and varying payback requirements. They are distinguished mainly by their ability (or inability) to direct residual amounts, and whether creditors can attach or seek repayment from trust assets. When using trust formats differing from the SNT, great care should be taken to assure there is no conflict with needs-based entitlement programs. Although it is possible that a trust, properly drafted and funded with assets not owned by or entitled to the disabled individual and settled by a third party, could be exempt from consideration, it is not a simple matter and can vary from state to state.

It is strongly recommended that qualified counsel, experienced in SNTs, be consulted.

<table>
<thead>
<tr>
<th>Table 1: Three Main Types of Special Needs Trusts</th>
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<tbody>
<tr>
<td><strong>Trust Format</strong></td>
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<tr>
<td>First-Party Special Needs Trust (d)(4)(A)</td>
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<tr>
<td>Third-Party Special Needs Trust</td>
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<td>(state provides statutory authority)</td>
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<td>Pooled Trusts (d)(4)(C)</td>
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<td>Miller Trust or Qualified Income Trust (d)(4)(B)</td>
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before embarking on any action that may have legal or tax consequences.

First-Party SNTs
Practitioners commonly use the term “special needs trust” to designate trusts that are funded by assets belonging or awarded to the disabled individual. To shelter assets from needs-based eligibility guidelines, these trusts require reimbursement to the state agency from residual trust assets at the death of the disabled individual beneficiary. Amounts remaining after repayment, if any, may be distributed per the terms of the trust. These so-called “payback” trusts arise from 42 U.S.C. 1396p(d)(4)(A) and (d)(4)(C) and also may be referred to as “(d)(4)(A)” or “(d)(4)(C)” trusts.

Note that the (d)(4)(A) type of SNT must be established for the sole benefit of the disabled individual and funded before he or she reaches age 65. In addition, this type of SNT cannot be created directly by the disabled individual—even if that person has the capacity to do so.

A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1382c(a)(3) of this title) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court of the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this subchapter. (42 U.S.C. 1396p(d)(4)(A))

Third-Party SNTs
Third-Party SNTs are trusts that are funded and settled by a third party with assets not belonging to the beneficiary. Authorized under the trust or trustee statutes of individual states, these types of SNTs require careful drafting so that distributions do not conflict with or reduce Medicaid and other needs-based programs. In Illinois, for example, this type of SNT may be referred to as a 5/15 trust, after the relevant statutory authority found in the Trusts and Trustees Act at 760 ILCS 5.15 et seq. The Third-Party SNT is designed to improve the quality of life for the individual and to qualify as an “exempt asset” for the purposes of needs-based eligibility programs. At the death of the special needs individual, assets remaining in this type of trust are not subject to state agency repayment. Instead, the designated beneficiaries are entitled to the assets as specified under the terms of the trust. These trusts can be very useful in properly drafted estate plans and in conjunction with intervivos gifting goals. As with any tax or legal matter, qualified counsel should be consulted.

Pooled Trusts
A third type of SNT is referred to as the “pooled trust” because contributions are comingled or pooled for investment purposes. Each individual beneficiary has a subaccount that determines and tracks the amount of assets the individual is entitled to use. Created and administered by non-profit entities under state authority, pooled trusts are used when assets exceed aid thresholds but are not sufficient to justify the expense of drafting a separate trust under (d)(4)(A).

Enabled by 42 U.S.C. 1396p(d)(4)(C), the pooled trust has no age limitation. Unlike (d)(4)(A) trusts, the pooled trust can be used to shelter assets for disabled individuals over the age of 65. Although anyone can contribute to a pooled trust, these trusts usually are established by a parent, grandparent, guardian, court, or by the disabled individual (with requisite capacity). In addition to protecting assets from spending down to qualify for aid, pooled SNTs offer advantages that may include convenience, fiduciary oversight, cost-effective investment management, ease of administration, and inexpensive establishment and maintenance costs.

At the death of the beneficiary, some states will seek repayment for sums expended, while others will allow funds to stay in the pool or be otherwise directed. There is a great deal of latitude because the Omnibus Budget and Reconciliation Act of 1993 (OBRA) regulations allow up to 100 percent of the residual to be retained by the trust. However, the federal law also allows the individual states to provide their own, more restrictive, requirements, thereby resulting in significant variance across the country.

In conformance with federal law, Illinois is an unusual example that requires payback to the state only if sufficient funds remain for a 100-percent payback, i.e., trusts with smaller residuals are not subject to payback at all. Subject to the 100-percent payback requirement, Illinois also allows the entity creating the trust to retain a fixed percentage for use by other account holders in the pool. Remaining funds, if any, may be transferred to designated beneficiaries or donated back to the trust.

Some states, including Illinois, allow immediate Medicaid eligibility for a person over age 65 who shelters assets with a pooled trust. In Illinois, the Omnibus Budget Reconciliation Act of 1993 (OBRA) regulations allow up to 100 percent of the residual to be retained by the trust. However, the federal law also allows the individual states to provide their own, more restrictive, requirements, thereby resulting in significant variance across the country.

Some states, including Illinois, allow immediate Medicaid eligibility for a person over age 65 who contributes assets to a pooled trust. However, rules can vary from state to state because Medicaid, though authorized by the federal government, is implemented at the state level. Many states have a post-age 65 penalty for uncompensated transfers (i.e., when fair-market value is not received by the transferor from the trust). The penalty can require amounts paid out to be first used to offset all or part of the Medicaid costs incurred before qualification for Medicaid.

As with all Medicaid and state-provided entitlement programs, it is important to check your specific state regulations for guidance. In addition to differences by state, there are also differences among
different types of trusts within the same state. As a result, it can be economically beneficial to compare different types of trusts before embarking on a course of action.

The Miller Trust
About half of the states use spend-down approaches to Medicaid eligibility. Other states use income-cap rules where Medicaid eligibility is limited because income exceeds certain limits. When (d)(4)(B) income trusts are used, certain entitlement programs may not provide for nursing facility expenses and also will not allow individuals to spend down to qualify for Medicaid facility payments. Income-cap states currently include AL, AK, AZ, CO, DE, FL, GA, ID, IA, KY, LA, MS, NV, NJ, OK, OR, SC, SD, TN, TX, and WY.

In the income-cap states, one method to solve this issue is known as the Miller Trust or Qualified Income Trust (QIT). A QIT can be established to receive the amount of income in excess of the income cap. Enabled by 42 U.S.C. § 1396p(d)(4)(B) and an offshoot of Miller v. Ibarra, 746 F. Supp. 19 (D. Colo. 1990), this irrevocable trust may provide Medicaid eligibility in cases where it would otherwise be denied. Income (only) from annuities, pensions, government assistance, and other sources is paid into the trust and distributed in the month in which it is received. No assets, other than income, may be contributed to a Miller Trust.

The Miller Trust can provide the settlor with a monthly income, so long as the total from all sources is below the threshold amount. In certain states, additional sums may be paid to the spouse of the beneficiary, again assuming that total spousal income remains below the cap amount. Additional income is then paid to the care provider, often a nursing home, to offset the Medicaid cost. At the death of the beneficiary, any remaining funds are used to reimburse the Medicaid agency. Again, rules vary by state and should be carefully considered before taking action. Although many state Medicaid agencies have pre-approved trust forms and/or guidelines, they will usually not provide tax or legal advice.

Thoughts for the Future
An additional use of SNTs (beyond maintaining eligibility for benefits) also may include a care plan, life plan, or memorandum of intent to help an incoming trustee understand the goals of the settlor regarding quality of life and treatment needs. These documents are designed to communicate the wishes and knowledge of the parent or caregiver and can be invaluable in helping future caregivers understand the history of the disabled individual.

As an overview, a life plan can help maintain and improve quality of life and protect the special needs individual from some of the stress and disruption that can accompany changes in primary caregivers and trustees. Drafting a life plan can be a structured process or a simple a handwritten statement of a parent’s wishes for a child. Many private and nonprofit resources are available to help benefactors explore options and guide creation of a plan. With modest forethought, difficult transitions can be made easier and outcomes more successful.

David J. Gordon, CFP®, CIMA® is an Executive Director–Financial Advisor and Senior Portfolio Management Director with the Gordon Financial Group at Morgan Stanley in Deerfield, IL, where he specializes in fee-based portfolio management and comprehensive financial planning. Kirsten Gordon, CFP®, is a Financial Advisor with the Gordon Financial Group at Morgan Stanley and former teacher and school board president. Contact them at gordonfinancialgroup@morganstanley.com.

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