Special Needs Trusts
ABLE Accounts

Greater Boca Raton Estate Planning Council

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1. Overview.

Special needs planning is a niche practice area within the estate planning field that requires a working knowledge of many different areas of the law, including tax, public benefits, trusts and estates, among many others. The experienced special needs planning practitioner will not only know the law, but will also be in a position to offer practical advice to his clients that will improve the lives of individuals with disabilities and their families. It is also very important to be familiar with local practice as this often differs from state to state or even from county to county. One aspect of special needs planning is special needs trusts ("SNTs"). This outline will explore the different types of special needs trusts that are available and when it is appropriate to consider them. The outline will also address certain drafting and administration issues. ABLE accounts, a relatively new tool in the toolbox of special needs practitioners, will also be discussed.

One of the goals of special needs planning is to allow the individual with disabilities to qualify for government benefits while also having a source of funds that can be used to pay for things that government programs will not pay for. By doing so, the quality of life of the individual with special needs is improved. As a practical matter, special needs planning may be appropriate for someone who is already on government benefits or for someone who may potentially need government benefits in the future.

The primary government benefit available for many individuals with special needs is Medicaid. If you are eligible, Medicaid will generally pay for medical expenses, including the costs of long-term care and other chronic illnesses. For many individuals with special needs, this is critically important since the benefits available under private insurance, even those policies offered under the Affordable Care Act, are extremely limited in this regard. Medicaid is a jointly funded, federal/state program in which the federal government pays a percentage of the cost, and the state(s) the remaining percentage, which varies by state. Medicaid is the payer of last resort. Thus, in order to become eligible for Medicaid, an individual must meet strict income and asset requirements which are set forth by each state.

Another important government benefit available for individuals with special needs is Supplemental Security Income (SSI). SSI is a federal program which pays a monthly stipend to those who qualify. For 2018, the maximum monthly benefit is $750, plus a $20 per month income disregard. SSI may also cover the cost of group homes or other residences for individuals with special needs. Both SSI and Medicaid are "means-tested," which means that, to qualify, the individual has to meet the requirements of each program. To qualify for SSI, an individual can have no more than $2,000 of non-exempt assets in his name. Moreover, both Medicaid and SSI have rules restricting transfers of assets to others, including transfers to trusts, in order to qualify. In addition to federal statutes and regulations, the Social Security Administration ("SSA") has issued the Programs Operations Manual System, commonly referred to as the "POMS."[1] Although the POMS should not have the same weight as federal regulations, they are often given great deference by the courts and are very relevant in a special needs planning practice since

[1] https://secure.ssa.gov/apps10/poms.nsf/partlist!OpenView

they represent the SSA's views on a variety of issues pertaining to SSI. SSI recipients who receive payments, from a trust or otherwise, for food or shelter, will have their SSI benefits reduced by either one-third[2] or by the presumed maximum value ("PMV")[3] of the third party's contribution. However, in many cases, it may be appropriate to allow for these types of distributions from an SNT under the proper circumstances, especially if they will improve the quality of life of the beneficiary.

1.1 Types of Special Needs Trusts.

There are generally two different types of SNTs: First party SNTs and third party SNTs. The primary difference being that in first party SNTs the assets used to fund the trust belong to the individual with disabilities; whereas, in third party SNTs, the assets used to fund the trust belong to someone other than the individual with disabilities. Under the umbrella of first party SNTs are pooled trusts. These types of SNTs are funded with assets of the individual with disabilities, but unlike other first party SNTs, they are managed and operated by a not-for-profit organization. By way of nomenclature, some practitioners refer to SNTs as "supplemental needs trusts" instead of "special needs trusts." The name is not important. What is important is the source of funds used to fund the trust.

1.2 First Party Special Needs Trusts.

Other names for a first party SNT include a "(d)(4)(A)" (referring to the federal statute 42 U.S.C. Sec. 1396p(d)(4)(A) which authorizes these types of trusts), "self-settled", or "payback" trust. The assets used to fund these types of trusts typically, but not always, come from medical malpractice or personal injury lawsuits, accumulated assets through work, improper estate planning by family members (including outright inheritance), or child support. One of the key characteristics of a first party SNT is that upon death, or early termination, of the trust, Medicaid, but not SSI, must be repaid for the cost of services provided. The states have varying interpretations of how to calculate this payback.

First party SNTs first came into existence in 1993 with the enactment of "OBRA '93"- the Omnibus Budget Reconciliation Act of 1993. Basically, the law provides an exception to the Medicaid and SSI transfer of asset provisions if assets are transferred to a properly executed first party SNT. In addition, those assets held by the trust do not count towards the asset limits allowed by SSI and Medicaid. In exchange for these two benefits (no penalty period and not counting the assets), the law requires those assets remaining in the first party SNT to be first used to repay the Medicaid program for benefits paid upon death of the beneficiary or other early termination of the trust. To be a valid first party SNT, the trust must (1) contain the assets of an individual under age 65, (2) the individual must be "disabled," as defined by 42 U.S.C. Sec. 1382c(a)(3), (3) the trust must be established for the sole benefit of such individual by the individual, a parent,

[2] POMS HI 03020.045.

[3] POMS SI 00835.300.

grandparent, court or legal guardian, and (4) the trust must contain a Medicaid payback provision.

As noted, pooled trusts are a type of first party SNT managed and operated by a not-for-profit organization. While each beneficiary of a pooled trust has a separate sub-account identifying his share of the total assets in the trust, the assets in the trust are pooled for purposes of investment and management. Moreover, an individual need not be under age 65 to join a pooled trust, although states have different rules on whether transfers of assets to a pooled trust by an individual who is age 65 or older are subject to the Medicaid transfer of asset provisions. Finally, these types of trusts have a modified payback meaning that, depending on state law, all or a portion of the assets remaining in the trust upon the death of the beneficiary may be retained in the trust to benefit other beneficiaries of the pooled trust instead of being repaid to Medicaid. Pooled trusts are a good option for an individual who is not going to be transferring a significant sum to an SNT. Most banks are reluctant to serve as trustee of an SNT or have very high minimum balance requirements. A pooled trust might also be a good option for someone who doesn't have a capable trustee to appoint or for someone age 65 or older who cannot set up a first party SNT. Pooled trusts have trustees who offer professional management and investment of funds and should be considered in appropriate cases. To join a pooled trust, an individual must sign a "joinder agreement."

1.3 Third Party Special Needs Trusts.

A third party SNT is a trust which is created by and funded with assets belonging to someone other than the individual with a disability. A typical example is parents creating a third party SNT for the benefit of their child with a disability. The parents' estate plan would typically provide that, upon their deaths, the assets that are to be allocated for the benefit of the child with a disability are to be placed in the third party SNT created for the child's benefit. The purpose of a third party SNT is to permit a parent, grandparent or other person to provide for the needs of a person with disabilities which are not being met by public benefits. If the funds were left outright to the individual with disabilities, he would be disqualified for Medicaid and SSI. Even "wealthy" families may benefit from special needs planning depending on a number of factors, including the anticipated cost of care, the age of the person with special needs, the type of disability he has, and the community where he resides, among others. Moreover, there can be no assurance that a family's wealth will continue to the next generation(s), potentially increasing the need to rely on government benefits to pay for, at least part, of the care of the individual with disabilities.

Third party SNTs are not governed by federal law, although some states have statutes which address them.[4] Third parties can generally include anyone other than the person with disabilities, although there may be other issues to address if the beneficiary is a minor child or spouse or someone else who the creator of the trust has an obligation to support. Prior to drafting a third party SNT, it is important to determine which public benefits the beneficiary is receiving or may receive in the future. Whether the funds in a

[4] Among them are Minnesota, New York, Arizona, California, New Hampshire, Maryland, New Jersey, Illinois, Indiana, Kentucky, South Carolina, Tennessee, Wisconsin, and Pennsylvania.

third party SNT are considered a resource will often depend upon the terms of the trust, including the existence of a support standard, the extent of discretion given to the trustee and whether the beneficiary can compel a distribution. The settlor's intent to create an SNT should also be clearly stated in the trust instrument. Use of the words "supplement, rather than supplant government benefits" are typically good indicators of the settlor's intent. In determining whether the assets of a third party SNT have any effect on the beneficiary's eligibility for SSI, it is important to review the POMS to ensure that all requisite criteria are met so that trust assets do not disqualify the beneficiary for benefits.[5]

A third party SNT can be created by a revocable inter-vivos trust, an irrevocable inter-vivos trust, or a will. One of the benefits of creating a third party SNT during lifetime is that other relatives can leave assets to this trust if they so desire. Thus, it can serve as a vehicle to receive potential bequests from others thereby ensuring that the beneficiary's government benefits are protected. If the SNT is irrevocable, the settlor can engage in his own estate tax planning through the use of lifetime gifts to the trust. The draftsperson of the trust should be careful not to give Crummey rights of withdrawal to the beneficiary with disabilities as this may result in trust assets being considered an available resource of said beneficiary for SSI and Medicaid purposes. Moreover, the failure to exercise the right of withdrawal may be considered an uncompensated transfer resulting in a penalty period with respect to the beneficiary's eligibility for those benefits. If the SNT is revocable, it is imperative that there be a provision to convert it to an irrevocable trust upon the receipt of funds from persons other than the settlor. Without such a provision, it is unlikely that others would contribute assets to the SNT for fear that the trust could be revoked and the funds not used to enhance the quality of life of the beneficiary with disabilities. When drafting an SNT for a surviving spouse who is receiving, or expected to receive Medicaid benefits in the future, the SNT must be a testamentary trust created in a will. Assets contained in an inter-vivos trust created by a spouse will be considered an available resource of the surviving spouse for public benefits purposes.[6]

A third party SNT does not have to be for the sole benefit of the individual with disabilities; whereas, a first party SNT must be. Thus, it is permissible to have beneficiaries of a third party SNT who are not disabled. For families with more than one child, the assets can either be left to one "pot" trust which has sprinkling provisions or to separate trusts set up for each child. There are conflicting views as to which is the best approach. The benefit of a pot trust is that the trustee can use the money where it is determined to be most appropriate among all the children. However, this can lead to an unfair (in someone's eyes) allocation of resources depending on the circumstances. By leaving the assets in separate trusts and having one of them be a third party SNT, it is clear from the beginning the amount of funds each beneficiary was intended to receive. However, this approach will not afford the trustee the flexibility, if needed, to spend additional funds (beyond what is in that person's SNT) to enhance the quality of life of the individual with disabilities.

[5] POMS SI 01120.200.

[6] 42 U.S.C. Sec. 1396p(d)(2)(A).

Unlike a first party SNT, any funds remaining in the third party SNT at the time of the death of the beneficiary are not subject to Medicaid payback. This makes sense since the creator of the trust would otherwise have no legal obligation to use those funds to pay for the expenses of the beneficiary. Thus, they should not be subject to a Medicaid payback. A third party SNT often resembles a traditional discretionary spendthrift trust drafted to protect the trust assets for the benefit of a person who is vulnerable to exploitation or who does not manage money well. In order for a discretionary trust to meet the criteria of a special needs trust, and thus be exempt from consideration when determining financial eligibility for public benefits, the trust must limit the powers of the beneficiary, the authority of the trustee, and the trust must include a spendthrift clause.[7]

An alternative to a third party SNT is to disinherit the person with disabilities. While this will accomplish the goal of not disqualifying the individual for government benefits, it will not further the goal of enhancing his quality of life. Alternatively, some families consider leaving the assets to a third party (perhaps a sibling) who makes a verbal commitment to assist the person with a disability. Unfortunately, this type of arrangement puts the person with disabilities at risk. The person who is entrusted with the funds could pass away prior to the death of the individual with disabilities, get divorced, get married, become disabled himself, get sued, etc. For the foregoing reasons, this option does not work for most families since it does not ensure that there will be available funds to enhance the quality of life of the individual with disabilities.

1.4 ABLE Accounts.

ABLE accounts are modeled after Internal Revenue Code ("IRC") section 529 Plans and are tax-advantaged accounts that grow tax-free and receive favorable treatment for certain means-tested government benefit programs so long as program requirements are fulfilled. The envisioned purpose of ABLE accounts was to provide secure funding for disability-related expenses on behalf of designated beneficiaries with disabilities that will supplement, but not supplant, benefits otherwise available to those individuals, whether through private sources, the government, or otherwise. The goal was to create a vehicle that was simpler than an SNT, and did not require professionals such as lawyers and trustees, or court involvement.

Although the ABLE Act is federal law, each state can choose whether to have an ABLE program and must enact its own state law before establishing ABLE accounts. States have the option to participate. Several states have declared their intention to not participate due to reasons such as the cost of administering the program. When first enacted, only residents of the state could participate in the ABLE program for that state; however, the law was subsequently amended to allow non-residents to create ABLE accounts in a state other than their home state. Certain states, currently including Florida, Georgia, Kentucky, Louisiana, Missouri, New York, Vermont and West Virginia have ABLE programs for residents only. Oregon currently runs two programs, one for residents and one for non-residents.

[7] POMS SI 01120.200.

In order to be eligible for an ABLE account, the onset of the individual's disability must have occurred prior to age 26. Each calendar year, the individual with disabilities, or another person for their benefit, can make a contribution in any amount up to the federal annual gift tax exclusion amount, presently $15,000, into an account in the name of the individual with disabilities. Contributions must be made in cash. Aggregate annual contributions from all sources cannot exceed $15,000. There is no federal income tax deduction for contributions made to an ABLE account. However, some states have passed legislation providing for a state income tax deduction or tax credit for ABLE account contributions.

Total contributions into the ABLE account are capped at each state's limitations for 529 accounts and the first $100,000 in an ABLE account will not adversely affect the individual's eligibility for SSI. So long as the funds in that account are used for permitted government-approved disability-related expenditures, the account will be permitted to accrue value income tax-free. An individual can have only one ABLE account. While contributions are completed gifts for tax purposes, there is no five-year up-front funding as there is for 529 accounts.

Funds in an ABLE account must be used for "qualified disability expenses." Non-qualifying distributions are subject to a 10% penalty. This term is broadly construed and is not limited to expenses for items for which there is a medical necessity or which provide no benefit to others in addition to the benefit to the designated beneficiary. This is in stark contrast to a first party SNT which must be established and administered for the "sole benefit" of the individual with disabilities.

Upon the death of the designated beneficiary, the balance of the ABLE account is subject to recovery by the state's Medicaid agency, which provided benefits to the beneficiary during his life. The payback is limited to the account balance of the ABLE account. Neither the designated beneficiary nor his family is personally responsible. Thus, if the money contributed each year is spent in a short period of time, this can minimize the payback. However, for some beneficiaries this may be inconsistent with a desire to save money for a large purchase in the future. The payback applies to all funds in the ABLE account, even those funds contributed by third parties. This is a major distinction between an ABLE account and a third party SNT, where there is no Medicaid payback. The Medicaid recovery is limited to the period in which the ABLE account was in existence. This is a significant difference from first party SNTs in some states, which seek recovery for all Medicaid ever paid on behalf of the beneficiary, since birth. Some states have recently indicated that they do not intend to pursue the ABLE Medicaid payback.

The Tax Cuts and Jobs Act of 2017 made two significant changes to ABLE accounts. First, rollovers from 529 accounts are now permitted up to the $15,000 annual limit. Rollovers may be made from the 529 account of the ABLE designated beneficiary or certain family members. Second, the designated beneficiary may now contribute annually an amount capped at the lesser of (1) the federal poverty level for a one-person household (approximately $12,000) or (2) his compensation for the year. This

contribution is in addition to the $15,000 annual limit. Additionally, the designated beneficiary may claim a saver's credit up to $2,000 for that year if he qualifies. No additional contribution may be made if a contribution was made to the designated beneficiary's retirement plan that year. These two provisions sunset on December 31, 2025.

2. Taxation of Special Needs Trusts.

2.1 First Party Trusts.

All first party SNTs are irrevocable. Irrevocable trusts are generally taxed at a much higher rate than individuals. Due to the compressed income tax rates for trusts, if the taxable income of the trust exceeds $12,500 the trust income will be taxed at the highest federal marginal income tax rate of 37 percent (plus the Medicare and net investment income surtax). Whereas, an individual is not taxed at the 37 percent marginal rate until income exceeds $500,000. This can be a significant issue for SNTs since not all income is typically distributed. To address this concern, the trustee can invest trust assets in items which do not generate taxable income subject to the highest rates. Alternatively, the draftsperson can include provisions in the trust which cause it to be treated as a grantor trust for income tax purposes under IRC sections 671 through 677. One of the benefits of grantor trust status is that all trust income flows through to the grantor and is taxed at the individual income tax rates and not the trust tax rates. In a first party SNT, the grantor is typically the individual with disabilities who would be in a much lower tax bracket than the trust. The practitioner needs to exercise caution when drafting a first party SNT since some of the grantor trust provisions are not well-understood by local Medicaid agencies and may cause issues in having the trust qualify as an exempt trust for SSI and Medicaid purposes. For example, Medicaid might take the position that if the grantor has a power of appointment or the power to substitute property of equivalent value, that these powers could violate the "sole benefit" rule or otherwise give the grantor/beneficiary too much control over the trust to allow it to be an exempt resource.

Contributions to a first party SNT are generally not subject to gift tax for a number of reasons. Unless the trust is set up in one of the asset protection states, the assets held by a first party SNT are subject to the claims of the grantor's creditors. The IRS has ruled that this makes the gift to the trust an incomplete gift for tax purposes.[8] In addition, the assets held by a first party SNT must be used for the sole benefit of the grantor/beneficiary during lifetime and be payable to his estate on death. Thus, it is unlikely that transfers of assets to a first party SNT would be considered a completed gift for tax purposes. If permitted by the local Medicaid agency, you may consider having the grantor reserve a testamentary limited power of appointment in the trust assets. This would ensure that there would be no completed gift.

First party SNT assets are generally included in the grantor's estate for estate tax purposes. Administration expenses, including attorney's fees, and the payback to

[8] See Rev. Rul. 76-103.

Medicaid are allowable deductions on an estate tax return. For 2018, the federal estate exemption is $11,200,000.

2.2 Third Party Trusts.

If a third party SNT is revocable, then all income tax is reported on the settlor's personal income tax return. If the trust is funded, it will not be a completed gift for gift tax purposes and the trust corpus will be includable in the settlor's gross estate upon his death. Upon the settlor's death, the trust becomes irrevocable. Be careful if this type of trust is to be funded from sources other than the settlor as there may be unintended estate tax consequences.

Generally, the same grantor trust rules that apply to first party SNTs also apply to third party SNTs. The primary difference is that, in a third party trust, the settlor is not the beneficiary with special needs. Also, testamentary supplemental needs trusts cannot be considered grantor trusts as the settlor is no longer alive. A third party trust can retain its grantor trust status so long as the grantor is alive. Giving an irrevocable inter-vivos third party trust grantor trust status can be an important estate planning tool for families who want to preserve trust assets and decrease their net worth by paying income taxes.

A qualified disability trust ("QDT") can claim an exemption in the amount of $4,150.[9] In order for a third party SNT to qualify as a QDT, the trust must not be a grantor trust and it must be established for the sole benefit of an individual under age 65 who is disabled. Thus, a first party SNT would not typically qualify as a QDT because it is usually a grantor trust.

Inter-vivos third party SNTs will generally not be included in the settlor's estate so long as the settlor retains no dominion or control over the trust. Thus, any contributions to the third party SNT during the settlor's life will not be included in the settlor's gross estate. If estate taxes are a concern for the settlor, Crummey powers may be utilized in a third party SNT to allow contributions to the trust to qualify for the annual gift tax exclusion. Caveat: you should not provide for Crummey rights of withdrawal powers to a beneficiary who is disabled. It is possible that the SSA or Medicaid could take the position that a disabled beneficiary's Crummey right of withdrawal could cause the assets of the trust to be available to that beneficiary. Further, the lapse of the power could be considered a gift as well.

3. Drafting Considerations.

3.1.1 Trustee Selection.

The selection of the trustee is one of the most, if not the most, important decisions in determining whether the special needs plan you have created will ultimately work for your client and his family. The perfect trustee should be knowledgeable in many areas, including trust law, tax law, public benefits law, investments, medical issues, education

[9] IRC § 642(b)(2)(C)(iii).

issues and advocacy issues. Obviously finding the perfect trustee is not always possible. This is an area where the input of an experienced special needs trust practitioner can be extremely useful to the client.

The trustee may be a family member, professional colleague or a corporate fiduciary. It is not recommended that the beneficiary himself serve as trustee. The government would likely argue that this would give the beneficiary too much control over the trust property, and it could cause the trust assets to be considered an "available" resource for Medicaid and SSI purposes. It makes sense for many clients to consider appointing co-trustees: a family member and a professional trustee. The family member trustee can deal with the advocacy and care issues, while the professional trustee can take care of the investment and compliance issues.

An SNT differs from a more traditional trust since the beneficiary may be on government benefits and there may be accounting or other requirements that cause the government to be an interested party. In addition, for a first party SNT, the government receives the payback on the death of the beneficiary or early termination of the trust. Thus, there may not be the same desire to maximize total overall return since there will be immediate needs of the beneficiary that must be met. In any event, the trustee must keep accurate records and make sure that distributions do not inadvertently violate the Medicaid or SSI rules.

3.1.1 Professional Trustee.

In many cases, the client will be well-served by having a professional serve as trustee of an SNT. Of course, this will likely mean increased expense compared to a family member; however, in most cases this will be well worthwhile. Most family members have never served as trustee of any kind of trust, much less an SNT. There could be a tendency to treat the trust money as their own or comingle the funds with their own. This is especially troublesome when the beneficiary with special needs is not capable of monitoring the trustee's actions. It is important to have a trustee who will take the time to get to know the beneficiary and who will investigate and understand his needs. In a first party SNT, the trustee must have the backbone to refuse to make inappropriate distributions that are not for the sole benefit of the beneficiary and also be flexible enough to make distributions that will enhance the quality of life of the beneficiary. Be careful, as not all professional trustees will take the time to do the job properly. Increasingly, courts are becoming less tolerant of SNT trustees who simply invest the money, take their fees and do nothing much else to benefit the beneficiary. Courts are holding trustees of an SNT to a higher standard, often requiring them to apply for public benefits on behalf of the trustee or make distributions that improve the quality of life of the beneficiary. For this reason, among others, many banks and trust companies will not serve as a trustee of an SNT. It is important to work with a trust company that seeks out this type of business and will do a good job.

When utilizing a corporate trustee, make sure you incorporate their fee schedule into the trust document. Most banks and trust companies have a minimum annual fee or

may have a minimum corpus requirement. In many cases, this will be an impediment to appointing a corporate trustee. It is important for you to establish relationships with professional trustees who seek out this type of business and who are flexible when it comes to minimum corpus requirements.

3.1.2 Trust Protector.

It is often appropriate to appoint someone or entity as trust protector to have the authority or duty to oversee the trustee in an SNT since the beneficiary often cannot serve this role. For example, a beneficiary with cognitive impairment would not be able to review the accountings of the trustee. A trust protector can have a number of roles, depending on state law and the trust instrument itself. It is important to carefully think through which powers you give to a trust protector, as these can vary widely. They can be merely administrative in nature or can be substantive. You must decide whether the trustee has to follow the direction of the trust protector or whether the trust protector is merely acting in an advisory capacity. Depending on the powers given to the trust protector, fiduciary responsibility may attach thereto.

3.1.3 Trustee Discretion.

SNT practitioners frequently debate whether an SNT should include very specific distribution standards or standards which are broad in nature. The theory behind specific standards is the hope that it will provide clear guidance to trustees (and beneficiaries and family members) as to what is intended with respect to permissible distributions. The thought is that this will reduce any potential litigation risk or the need to seek court approval for distributions. However, by being specific, you may run into problems getting your trust approved by SSA since they change their policies and the POMs from time to time. One of your provisions may run afoul of a new POMS provision which changes SSA policy on a particular issue. Conversely, it is thought that broad standards allow the trustee to exercise its unfettered discretion to make a distribution to improve the quality of life of the beneficiary in accordance with the trust instrument. In fact, many corporate trustees actually prefer this to a specific standard. After all, it is very hard to anticipate at the time of drafting all the future possible needs of the beneficiary. One of the drawbacks of a broad standard is that the trustee often feels the need to seek court approval for certain distributions since they are not specifically stated in the trust. With respect to this issue, there is no “one size fits all” approach that can be applied to all trusts. Each case must be thought through and discussed with the relevant parties prior to drafting the trust.

One drafting issue with respect to trustee discretion that deserves some thought is whether the trustee should be permitted to make a distribution even if it reduces or eliminates the beneficiary’s entitlement to government benefits. If this type of distribution would improve the quality of life of the beneficiary, then perhaps it makes sense to make the distribution even if it has a negative impact on government benefits.

3.1.4 Trustee Powers.

In an SNT it is important for the trustee to have the power to invest trust assets in non-income producing assets, such as a car or a house. Also, in an SNT, preservation of principal may not be paramount since the intent is to improve the quality of life of the beneficiary with special needs and the interests of the remaindermen typically fall behind the lifetime beneficiary.

3.1.5 Trust Amendment.

Due to a rapidly changing regulatory and legal landscape, it is possible that an SNT will need to be amended after it is executed. For example, if the beneficiary moves to another state and the new state's Medicaid agency doesn't agree with certain trust provisions and requires that they be removed or amended before Medicaid will be granted in that state. Another example is that the POMS are constantly changing and may cause the exempt trust to no longer be exempt. This is a major reason why the draftsperson needs to incorporate flexibility into the trust so that it may be amended when necessary. Even though decanting or reformation may be available, it is almost always more cost effective and practical to amend the trust if the power to do so is included in the trust document. If the original trust is a first party SNT which was approved by a court, it is quite possible that the court will insist on approving any modifications to the trust.

3.1.6 Other Provisions.

The trust should also give the trustee the power to hire other professionals, including lawyers, accountants, and care managers. Be mindful that in first party SNTs, professional fees may be subject to court approval.

4. Trust Administration Considerations.

4.1.1 Family Member as Caregiver.

Frequently, parents of children with disabilities need to stay at home and care for their child and cannot be out in the regular workforce causing some parents to give up successful careers. Other times, parents cannot rely on the Medicaid system to provide appropriate aides for their child. Questions often arise regarding whether the trust should pay for private aides, or pay the parent as a caregiver. A third party SNT can provide for this type of compensation. However, when dealing with first party SNTs, even if the trust grants this authority, a corporate trustee may still wish to notify Medicaid and seek court approval. A few years ago, the POMS actually had a provision that would have prohibited first party SNTs from paying family members as caregivers unless the family member was certified. Interestingly, the POMS did not define who was a family member or how one would become certified. The provision was purportedly put in place because SSA was concerned about alleged abuses of certain family members who were taking advantage of the trust beneficiary who had disabilities.

4.1.2 Travel Expenses.

Another POMS provision which was also subsequently withdrawn would have treated a trust provision which allowed the first party SNT to pay for the travel of someone else as a violation of the "sole benefit" rule resulting in trust assets being considered an available resource. This POMS provision has since been revised to permit payment by first party SNTs of travel expenses of non-beneficiaries in limited circumstances. The revised rule provides that payments to third parties do not violate the sole benefit rule if they are for goods and services received by the beneficiary or payments for travel expenses of third parties which are necessary for the trust beneficiary to obtain medical treatment or payments that allow a third party to visit a beneficiary who resides in an institution, nursing home, or other long-term care facility (i.e., group homes and assisted living facilities), or other supported living arrangement in which a non-family member or entity is being paid to provide or oversee the individual's living arrangement. However, the travel must be for the purpose of ensuring the safety and/or medical well-being of the individual.[10] It is important to note that these provisions are limited solely to those beneficiaries receiving SSI and also do not apply to third party trusts. Thus, payment from third party SNTs to reimburse travel expenses of family members is permissible so long as the trust provides for such reimbursement.

4.1.3 Housing Options.

The purchase of a home for someone with disabilities is something that can improve his quality of life for a long time. However, a home purchase often presents a number of complex issues at the time of purchase and during the time period that the beneficiary resides in the house. For this reason, many practitioners suggest that a beneficiary rent instead of owning a home. If the decision is made to purchase a home, a threshold question is whether the purchaser of the home should be the trust, the beneficiary, or some other third party. If a first party SNT owns the home, then the value of the home will be subject to the Medicaid payback upon the death of the beneficiary. If the beneficiary owns the home, the Medicaid payback will not apply; however, Medicaid may, under certain circumstances, place a lien on the home, or, the value of the home may be subject to Medicaid estate recovery upon the death of the beneficiary. Pursuant to 42 U.S.C. Sec. 1396p(b)(1)(B), Medicaid may have the right to recover for certain long-term care benefits paid after the beneficiary attained the age of 55. With respect to third party SNTs, it often makes sense for the SNT to own the home since there is no Medicaid payback in those types of trusts.

When purchasing a home, the question invariably arises as to whether the purchase should be financed. The proceeds of a mortgage will not be considered income for SSI or Medicaid purposes so long as they are used to purchase the home in the same month in which they are received. If the trust owns the home, it may be difficult for the trustee to qualify for a mortgage. Of course, this situation can be ameliorated if the trust company and the mortgage company are owned by the same entity. If the home purchase transaction is structured so that the beneficiary owns the home, it may also be

[10] POMS SI 01120.201 F.2.b.

difficult to obtain a mortgage since many beneficiaries do not work or have poor credit. For this reason, it is common for home purchases to be all cash transactions.

If a house is owned individually by a first party SNT beneficiary, it may not make sense for the ownership to be transferred to the SNT if the beneficiary is under age 55 since Medicaid does not have a right of recovery for benefits paid to an individual prior to age 55. If ownership of the house is transferred to the first party SNT and other family members are living in the house owned by the trust, the trustee should consider contributions from those family members. This is especially true in first party SNTs since you want to make sure that the trust does not violate the sole-benefit rule by allowing others to live in the house rent-free. In these situations, it is often necessary to charge the other family members rent. If the other family members provide care to the beneficiary that allows him to stay at home, that can be a mitigating factor.

4.1.4 Purchase of a Vehicle.

A trust can purchase a vehicle for the benefit of a beneficiary. It is important to consider who should be the owner of the vehicle. In some cases it makes sense to title the vehicle in the name of the beneficiary or family member. This way, if a car accident occurs in which the beneficiary or family member was responsible, it will minimize the exposure of trust assets in any subsequent litigation. It is suggested that the trust hold a lien on the title of the car so the beneficiary or family member cannot sell the vehicle.

4.1.5 Payback Provision.

As previously noted, all first party SNTs must include a "payback" provision at the death of the beneficiary or early termination of the trust. It is important to remember that the payback is only for Medicaid expenditures and not SSI. Be mindful that beneficiaries sometimes move during lifetime and thus receive Medicaid benefits from more than one state. Upon death, the respective states will be entitled to a pro-rata allocation of whatever remains in the trust on death. Also, different states may have different rules regarding how far back the payback must go. In many states, the payback includes Medicaid expenditures incurred prior to the creation of the trust.

Some, but not many, expenses receive priority over the Medicaid payback. For example, trust administration expenses and federal and state estate taxes may be paid prior to repaying Medicaid. Debts due third parties, funeral expenses and payments to residual beneficiaries cannot be paid until the state is reimbursed for Medicaid paid. For this reason, it is critically important that burial and funeral expenses be prepaid by using a Medicaid-exempt, irrevocable prepaid funeral contract prior to the beneficiary's death. In fact, the properly drafted first party SNT should include a provision authorizing the trustee to spend trust assets for this purpose. When determining the amount to be paid back to Medicaid, it is important to review a report provided by Medicaid which details each and every expenditure made by Medicaid on the beneficiary's behalf. Frequently, there are errors, including care provided to other individuals and payment for special education and related services, which are not subject to payback.

5. Common Errors.

Set forth below are some common errors practitioners make when representing clients in the special needs planning and SNT area. These are by no means exhaustive, but merely a sampling of some of the things that can go wrong if careful attention is not paid to detail and all scenarios are not thought out properly. Each client situation must be evaluated on its own as one size does not fit all in this area.

5.1 Not being flexible in drafting. You must carefully consider the needs of the trust beneficiary and circumstances of the particular matter. The trust should not be "cookie cutter," but rather an instrument that will provide flexibility to meet the beneficiary's needs for years to come. The goal of most clients is to improve the quality of life of the individual with special needs. They are relying on the trust draftsperson to draft a document and put in place a plan that will adapt to the changing needs of the trust beneficiary and the ever-changing status of the law.

5.2 Not creating a third party SNT for someone over 65. There is no law prohibiting the creation and funding of a third party trust for individuals with disabilities who are age 65 or older. This limitation applies only to first party SNTs. Third party SNTs also are a very effective planning too for married seniors when one of the spouses may be facing a long-term care situation.

5.3 Create first party SNT for someone over age 65. Federal law expressly prohibits the creation and funding of first party, self-settled trusts for individuals age 65 or older. If this type of trust was created, the beneficiary would be subject to transfer penalties and potential disqualification of public benefits. Moreover, since the trust must be irrevocable, it may be extremely difficult to undo this mistake and engage in proper planning.

5.4 Requiring mandatory distributions of income or principal. SNTs must be purely discretionary trusts. If the draftsperson puts in a standard pursuant to which the beneficiary can demand distributions from the trust then that could frustrate the entire purpose of the trust. Ideally, the trust should be designed to supplement, not supplant, government benefits. By requiring the trustee to make distributions, the beneficiary's right to certain government benefits could be compromised.

5.5 Spending third party trust assets prior to first party trust assets. Often, individuals with special needs are beneficiaries of both a first party SNT and a third party SNT. For example, they might have received a lawsuit settlement which was placed into a first party SNT and the parents might have funded a third party SNT. Since the third party SNT does not have a Medicaid payback provision, it is essential that assets of the first party SNT be spent first prior to expending any third party SNT assets.

5.6 Gifts to first party trust made by third parties. While this may seem obvious, unfortunately, it does happen. Since the first party SNT must have a payback provision,

it is imperative that any planning done by third parties include a third party SNT and that contributions by third parties go into the third party SNT and not the first party SNT.

5.7 Failure to coordinate with other relatives' planning. It is important to discuss with your client whether other family members are intending to leave assets to a child with a disability. After a client completes his estate planning, he should write a "Dear Family" letter to family members and inform them of the trust that has been put into place and how they can contribute to it if they wish to leave anything to the individual. This is one of the benefits of utilizing an inter-vivos third party SNT.

5.8 Failure to review and coordinate all beneficiary designations. In any estate plan, but especially in a special needs situation, it is important to review and coordinate beneficiary designations. You will be frustrating the intent and purposes of a third party SNT if the beneficiary designations of life insurance, retirement accounts, etc. leave assets outright to a person with special needs.

5.9 Not preparing a letter of intent. While not a legally binding document, a letter of intent is a critical component of a special needs plan. It provides a roadmap for future caregivers so that they can do the best job possible.

5.10 Failure to appropriately consider proper trustee. Too often, not enough time is spent discussing this very important decision. In many cases, the proper trustee is the key to the successful implementation of the plan and administration of the trust. Clients often wish to appoint a family member. However, family members often have a conflict of interest and have no experience serving as trustee. Serving as trustee of an SNT is even more complicated than serving as a trustee of a more traditional trust since the trustee must also be familiar with public benefit rules. In fact, some banks and trust companies refuse to serve as trustee of an SNT. Oftentimes, it makes sense to have co-trustees where the individual trustee can address the beneficiary's personal needs and the corporate trustee can handle the investment and compliance issues.

5.11 Failure to consider a trust protector. While a relatively new concept in the United States, the concept of appointing a trust protector is gaining traction, especially in SNTs. In an SNT, the beneficiary is often not able to monitor the actions of the trustee due to cognitive issues. Thus, a trust protector can serve a very useful oversight role in these cases. The trust protector can have a number of powers, including the power to make certain changes to the trust, the power to approve distributions, the power to change the trustee, among others. One issue you will want to consider is whether the trust protector will be a fiduciary. There are several states which have trust protector statutes and these must be reviewed if your trust is governed by the laws of one of those states.

5.12 Having remainder beneficiaries who are adverse to the beneficiary with disabilities. Too often, families lose sight of the fact that the SNT was set up primarily for the benefit of the person with disabilities. Practitioners need to be mindful of potential conflicting and hostile family relationships which may impact the administration of the SNT. For example, if the sibling is a trustee and also a remainder beneficiary, the sibling

may be hesitant to spend necessary money on the beneficiary for fear that their remainder interest will be diminished.

5.13 Failure to include a contingent SNT in Will. Many practitioners will not include an SNT in an estate plan because the family is not sure that the individual with special needs will ever need government benefits. In these situations, a contingent SNT works very well. The practitioner can draft the will leaving the assets either outright or in a non-SNT. If, at the time that the beneficiary becomes entitled to receive the assets, it is possible that government benefits may be in his future, then the SNT provisions can be triggered. This approach allows the decision on whether to utilize an SNT to be deferred, thereby giving all parties more time and information to make the proper decision.

5.14 Prohibiting disqualifying distributions. The goal of special needs planning is to improve the quality of life of the individual with special needs. In certain circumstances, the beneficiary may be better off if services or items are paid for by the trust even if this will have the effect of reducing or eliminating benefits. It is important that the trust allow for the trustee to exercise its discretion in this regard.

5.15 No provision to terminate third party trust if treated as available asset. Medicaid agencies are becoming increasingly aggressive in their treatment of trusts, including third party SNTs. For that reason it is important that the trustee (or someone else such as a trust protector) have the power to terminate the trust if Medicaid takes the position that the trust is an available resource. In that case, it may be important to remove the assets from the trust so that other planning may be implemented.

5.16 Include payback in third party trust. This is one surefire way to have an unhappy client and a malpractice case on your hands. Many practitioners don't understand the difference between a third party and a first party SNT and they think that all SNTs must have a Medicaid payback. That is simply not the case.

5.17 Give SNT beneficiary with disabilities Crummey powers. For tax planning purposes, it is often desirable for trust beneficiaries to have a Crummey right of withdrawal so that contributions to the trust qualify for the annual gift tax exclusion. If the trust beneficiary is receiving government benefits, however, it is possible that SSA or Medicaid could take the position that a disabled beneficiary's Crummey right of withdrawal could cause the assets of the trust to be available to that beneficiary. Further, the lapse of the power could be considered a gift as well. If estate and gift tax planning is important to the client, perhaps there are others, including contingent remaindermen, who you could give the Crummey power to.

5.18 Make first party trust revocable. First party SNTs must be irrevocable trusts. If the beneficiary has the power to revoke the trust, then the trust assets will be considered available for Medicaid and SSI purposes.

5.19 Include sprinkling provisions in first party SNT. A first party SNT must be for the sole benefit of the beneficiary with disabilities. Thus, first party SNTS may not contain

a provision which gives the trustee the power to distribute or sprinkle trust assets to other individuals. With respect to third party SNTs, sprinkling provisions are permitted although many practitioners prefer to set up separate trusts.

5.20 Not reviewing public benefits. Clients frequently do not know the exact benefits they are receiving. Always review written documentation of benefits eligibility. For example, if a beneficiary is receiving only SSDI and Medicare and it is never anticipated that he will be receiving any means-tested benefits, perhaps an SNT is not necessary.

5.21 Retirement benefits. If substantial retirement benefits are being funded into an SNT, the practitioner should consider whether it makes sense to use an accumulation trust as opposed to a conduit trust. While this might accelerate the payment of certain income taxes, it may preserve more of the trust corpus for the beneficiary when needed.

5.22 Knee-jerk SNT. In many cases, practitioners assume that an SNT is the best option, when in fact, that might not always be the case. In a third party SNT situation this can be addressed by using a contingent SNT. This allows for the creation of an SNT in the future if necessary. In a first party SNT situation, the amount of funds might be so substantial that it might not make sense to apply for means-tested government benefits. The beneficiary may be better off not being on Medicaid or SSI. Of course, each case must be evaluated on its own circumstances and merits.

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Greater Boca Raton Estate Planning Council
February 27, 2018

Special Needs Trusts
ABLE Accounts

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Special Needs Planning

- Goals
- Government benefits
  - Medicare
  - Social Security Disability
  - Medicaid
  - Supplemental Security Income (SSI)

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Special Needs Planning

- First Party Special Needs Trusts
  - (d)(4)(A)
  - Payback
  - Self-Settled
- Pooled Trusts
- Third Party Special Needs Trusts
  - Supplemental Needs Trusts
- ABLE accounts

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First Party SNT

- Funded with beneficiary's own assets
  - Personal injury
  - Inheritance
  - Matrimonial settlement
  - Improper estate planning
- Individual with disabilities under age 65
- Sole benefit of such individual
- Established by individual, parent, grandparent, legal guardian, or court
- Medicaid payback

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First Party SNT

- Assets not available
- No SSI or Medicaid penalty period
- Medicaid payback
  - Death or early termination
  - Debts due third parties
  - Funeral expenses
  - Residual beneficiaries

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Medicaid Payback

- Priority over payback
  - State and federal estate taxes
  - Trust administration fees
- Multiple states-pro rata
- Calculation of payback
  - Review services provided
  - Special education services
  - Services prior to creation of trust

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Pooled Trust

- d(4)(C)
- Run by not-for-profit organization
- Master trust
- Separate sub-accounts
- No age requirement
- Modified payback
- Good option for small amounts or where no suitable trustee

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First Party SNT Tax Issues

- Income tax
  - Compressed rates
  - Grantor trust
  - Medicaid issues
- Gift tax
- Estate tax
  - Medicaid payback deduction

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Third Party SNT

- Funded with assets of third party
- Disinherit/verbal commitment
- Even “wealthy” should consider
- No federal law
- No sole benefit requirement
  - Can have more than one beneficiary
  - Separate trusts versus one trust
- No age restriction
- No payback requirement

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Third Party SNT

- Testamentary
  - Required for spouse
- Inter-vivos
  - Revocable
  - Irrevocable
  - Letter to family
- Funding
  - Life care plan
  - Life Insurance

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Third Party SNT

- Wholly discretionary
- Ascertainable standard
- Support trust
- SNT
  - Express intent
- Contingent SNT

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Third Party SNT Tax Issues

- Income tax
  - Revocable
  - Irrevocable
    - Compressed rates
    - Qualified disability trust
- Gift tax
  - Crummey powers
- Estate tax

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Trustee Selection

- Key to success of SNT
  - Trust law
  - Investments
  - Tax law
  - Public benefits law
  - Medical issues
  - Education issues
  - Advocacy issues
- Corporate v. individual (or both)

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Trustee Powers

- Broad discretionary clause
  - Discretion to distribute for food, shelter, or items provided by gov't if the trustee deems it in the beneficiary's best interest, even if it reduces benefits
- Broad investment powers
  - Allow investment in anything Trustee deems to be in the beneficiary's best interest
  - Allow investment in non-income producing assets such as housing or vehicle
  - Preservation of principal may not be paramount

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Drafting Considerations

- Trust distributions
- Power to review trust books and records
- Request accountings
- Approve accountings
- Remove trustee
  - Good cause
  - Any reason
- Successor trustee
- Compensation
- Hire other professionals

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Drafting Considerations

- State law
- Amendments
  - Allow trust to be amended without court order
  - By trustee or trust protector
- Spendthrift provisions
  - Check state law re: creditor protection
  - Asset protection SNT

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Potential Conflicts

- Beneficiary disagrees with trustee
  - Trustee refuses to pay for something
  - Trustee insists on certain behavior from beneficiary prior to making distribution
- Family member disagrees with trustee
  - Distributions or items that benefit family members
- Trustee disagrees with government agency
  - Accountings
  - Notice provisions
- Legal fees

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Trust Protector

- One person
- Trust advisory committee
- Powers can be limited or broad
  - Amend trust
  - Approve distributions
- Ability to remove and replace trustee
  - Beneficiary may be unable to monitor trustee's actions
- Some state Medicaid agencies may not permit
- Fiduciary
- Compensation

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Administration Issues

- Transfer of jurisdiction
  - Family moves to another state
  - Original state may object to no payback
- Contribute d4a to d4c trust
  - Early termination

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Common Errors

- Not being flexible in drafting
- Not creating a third party SNT for someone over 65; thinking you can't
- Create first party SNT for someone over age 65
- Requiring mandatory distributions of income or principal or putting in a standard so beneficiary can demand distributions such as HEMS standard

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Common Errors

- Spend third party trust assets prior to first party trust assets
- Gifts to first party trust made by third parties
- Failure to coordinate other relatives' planning
- Failure to review and coordinate all beneficiary designations
- Not preparing a letter of intent

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Common Errors

- Failure to appropriately consider proper trustee; will they (can they) do their job?
- Failure to consider trust protector
- Putting in first party SNT provisions and citation in third party SNT
- Having remainder beneficiaries who are adverse to the beneficiary with disabilities

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Common Errors

- Failure to include a contingent SNT in will
- Prohibiting disqualifying distributions in all cases
- No provision to terminate third party SNT if treated as available asset
- Include payback in third party SNT

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Common Errors

- Give SNT beneficiary with disabilities Crummey powers
- Make first party SNT revocable
- Include sprinkling provisions in first party SNT
- Retirement benefits
- Knee-jerk SNT

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ABLE Act

- Section 529A; similar to 529 Accounts
- Optional for states to participate
- Several states are not participating
  - Administrative burden/cost
- Out-of-state owners permitted
  - Some programs are for residents only
  - Some limit state tax benefits to residents
  - Oregon has two programs

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ABLE Act

- Assets held by ABLE accounts do not disqualify individuals for gov't benefits
- Disability onset prior to age 26
  - Account may be created at any time
- Qualified disability expenses
  - Not taxable
  - No effect on government benefits
- Limit of one account per beneficiary
- Tax-free growth similar to Roth IRA

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ABLE Act

- Annual contributions (from all sources) limited to federal gift tax annual exclusion ($15,000)
- Aggregate contributions may not exceed state's 529 limit
- No federal tax deduction
  - State credit or deduction
- No five-year up-front funding
- $100,000 cap for SSI purposes
- Medicaid payback
  - Limited to amount in ABLE account

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Qualified Disability Expenses

- Education, housing, transportation, employment training, assistive technology, health, prevention and wellness, financial management and administrative services, legal fees, funeral and burial expenses and others approved by IRS
- Broadly construed
  - Not limited to medical necessity
  - No sole benefit requirement

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Tax Cuts and Jobs Act

- Additional contributions
  - By DB
  - No contributions made to retirement plan
  - Savers credit
- Rollover from 529 account
  - Applied to annual $15,000 limit
  - Family member
- Sunset provision

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