

Special Needs Planning
It is more than drafting a Trust

by

Andrew H. Hook, CELA, CFP®

Oast & Hook, P.C.
Offices in Virginia Beach and Portsmouth, Virginia
757-399-7506
www.oasthook.com

SPECIAL NEEDS PLANNING BASICS.....	1
Introduction.....	1
Purpose.....	7
Uses and Misuses.....	7
 MALPRACTICE FOR FAILURE TO PRESERVE PUBLIC BENEFIT ELIGIBILITY.....	 8
Personal Injury Case.....	8
Estate Planning.....	10
 AVAILABLE PUBLIC BENEFITS FOR PERSONS WITH DISABILITIES.....	 10
Comprehensive Plan.....	10
Benefits Not Based on Financial Need.....	11
Social Security Disability Insurance.....	11
Medicare.....	12
Special Education.....	14
Section 504 of the Rehabilitation Act of 1973.....	16
Americans with Disabilities Act.....	17
Consolidated Omnibus Budget Reconciliation Act.....	17
Health Insurance Portability Accountability Act.....	18
Military and Civil Service Survivor Benefits for Adult Children with Disabilities	
.....	18
Benefits Based on Financial Need.....	20
Supplemental Security Income.....	20
Medicaid.....	22
Group Health Insurance.....	25
Housing Choice Voucher Program.....	26
Veterans Administration Pension.....	27
 WHAT ARE THE ALTERNATIVES TO A SNT?.....	 28
Consider the alternatives to a SNT.....	28
Alternatives to a d(4)(A) or d(4)(C) SNT.....	28
Alternatives to a Third Party SNT.....	28
Current Developments.....	29
 DRAFTING A d(4)(A) SPECIAL NEEDS TRUSTS.....	 30
POMS Requirements.....	30
State Requirements and Decoupling.....	37
Medicaid Manual Requirements.....	40
Trustee.....	41
Prohibition of contributions after age 65.....	41

Trust Protector.	41
Distribution Provisions.	41
Bonding and Surety.	43
Qualification and Public Accountings.	43
Powers of Trustee.	43
Spendthrift Provision.	43
Fees, Taxes and Administration.	43
Trustee Compensation.	43
Amendment.	43
Grantor Trust Status.	44
DRAFTING A d(4)(C) SNTs.	44
POMS Requirements.	44
Drafting the d(4)(C) SNT.	45
DRAFTING PROVISIONS FOR THIRD PARTY SNTs.	45
POMS Requirements	45
Medicaid Requirements.	46
Purpose Clause.	47
Non-reduction clause.	47
Emergency clause.	48
Authority to rent property to the beneficiary.	48
Spendthrift Clause.	48
Discretion.	48
Termination Clause.	48
Amendment Clause.	49
Trustee.	49
Trust Protector.	49
Distribution Provisions.	50
Powers of Trustee.	50
Fees, Taxes and Administration.	50
Trustee Compensation.	51
Planning for Retirement Plan Distributions.	51
Caution.	51
SNT ADMINISTRATION.	52
Notification to the Social Security Administration	53
Notification to the State.	57
Trust Administration Duties.	57
Written Advice.	57
SSA Policy Concerning Disbursements from a SNT	57
Medicaid Requirements.	60

State Requirements and Decoupling.	60
Trust Taxation Issues.	61
Investment of Trust Assets.	65
LITIGATION ASPECTS OF ESTABLISHING SNTs.	66
Establishment Process for Inheritances and Excess Funds.	66
Establishment and Administration Process for Matrimonial Law.	67
Establishment Process for Personal Injury Claims.	68
Essential Special Needs Planning Library.	74
WHAT CONCLUSIONS CAN WE REACH?.	75

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I. SPECIAL NEEDS PLANNING BASICS

A. Introduction

1. In 2007, it is estimated that over 40 million Americans were disabled, one in seven.¹
 - a. The number of Americans with disabilities is expected to increase as the US population ages.
 - b. In light of the growing number of Americans with a disability, the need for special needs planning is growing.
2. A special needs trust (“SNT”) is a legal instrument used in the implementation of many special needs plans for persons with disabilities.
 - a. The SNT itself, however, is only a tool – a means to an end. To provide value added services, the attorney should, to the extent appropriate, also:
 - (1) counsel the client concerning available benefits and programs to address the client’s or beneficiary’s needs,

¹<http://www.ama-assn.org/amednews/2007/05/21/hlsb0521.htm>.

- (2) develop a comprehensive plan to provide for the needs and concerns of the disabled client or beneficiary and
 - (3) assist in the implementation of the plan.
 - b. Other legal instruments used by special needs planners include:
 - (1) Durable Powers of Attorney (DPOA)²
 - (2) Advance Medical Directives
 - (3) Support Trusts
 - (4) Guardianships
 - (5) Conservatorships
3. The special needs plan should identify the disabled person's needs and provide a comprehensive set of solutions that best address those needs.
4. Persons with disabilities have many needs beyond basic health care, food and shelter, including:
 - a. Recreation and related equipment (including sports equipment as bicycles adapted for the disability)
 - b. Transportation (including adapted vehicle conversions)
 - c. Dental Care
 - d. Telephone, internet and television services
 - e. Hair and nail care

²See Durable Powers of Attorney, Andrew H. Hook, 859-2nd T.M. for a discussion of the use of Durable Powers of Attorney (DPOA) in Special Needs Planning. Chapter XVI section C discusses using a DPOA to provide for incapacitated family members and Section R discusses use of DPOA in Special Education transition planning.

- f. Differentials in cost of housing and shelter
 - g. Supplemental nursing care
 - h. Private Case Management
 - i. Mobility aids, including electric wheel chairs
 - j. Private school tuition and therapies (such as music, sports and Applied Behavior Analysis that are common for children with autism)
 - k. Respite care
5. There are many resources that the attorney should consider in developing the special needs plan to address these needs, including personal resources, personal insurance (such as life and health), group insurance, and public benefits. Some of these public benefits (including Supplemental Security Income ("SSI") (See Section III (C) 1, below) and Medicaid (See Section III (C) 2, below)) have resource and income eligibility rules.
6. To provide for the payment of these needs, federal law permits a persons with disabilities to retain his or her resources in one of two types of SNTs without those resources disqualifying him or her from SSI³ or Medicaid benefits⁴. The two types of trusts are:
- a. d(4)(A) SNT.⁵ A d(4)(A) SNT is a trust created (and funded) for the sole benefit of an individual with a disability under the age of 65 by the individual's parent, grandparent, legal guardian or court. The trust is funded with the disabled person's assets. The trust must provide that the state Medicaid agency will receive amounts remaining in the trust upon the individual's death up to the amount paid by each state under the Medicaid program for services to the disabled individual. (See, Section V, below) (See, Exhibit 6 for a sample form of d(4)(A) SNT).

³42 U.S.C. §1382b (2008).

⁴42 U.S.C. §1396p(d)(4) (2008).

⁵42 U.S.C. §1396p(d)(4)(A) (2008).

b. d(4)(C) "Pooled" SNT⁶. A d(4)(C) SNT is a trust created and managed by a nonprofit organization. A separate subaccount is maintained for each beneficiary of the trust, but the assets are pooled for investment and management purposes. The account is created for the sole benefit of an individual with a disability by the individual's parent, grandparent, legal guardian, court, *or the individual*. (See, Section VI, below) The trust is funded with the disabled person's assets. Some states, including North Carolina⁷ and Virginia⁸, require the d(4)(C) SNT to be funded by the disabled individual before he or she attains age 65, otherwise any funding by the disabled individual with his or her assets after that age may constitute a divestment by the disabled individual (See, Section VI (A) 4, below).

(1) One of the most significant differences between a d(4)(A) and a d(4)(C) SNT is the ability of an individual with disabilities to create his or her own pooled trust subaccount with a d(4)(C) SNT.

(2) The d(4)(C) SNT must provide that to the extent that funds in the disabled individual's account are not otherwise retained by the d(4)(C) SNT upon the individual's death, the state Medicaid agency must receive the amounts remaining in the subaccount up to the amount paid by the Medicaid program for the individual.

c. A d(4)(A) and a d(4)(C) SNTs are referred to as a "self settled SNT" or a "first party SNT".

7. Third parties such as parents, grandparents (but including friends and more remote relatives) may establish and fund with their assets a SNT to protect the SSI and Medicaid eligibility of a disabled person. The SNT will provide additional resources to meet those needs not meet

⁶42 U.S.C. §1396p(d)(4)(C) (2008).

⁷North Carolina MA-2240 VIII.B.1

⁸Virginia Medicaid Manual §M1120.202.

by those public benefits. A SNT created by a third party is called a third party SNT. (See, Section VII, below.)

- a. A third party SNT is a special needs trust created and funded with the assets of a person other than the disabled beneficiary.⁹
 - (1) As part of their estate planning, parents, grandparents, or other family and non family members frequently create and fund third party SNTs for the benefit of their beneficiaries who have disabilities.
 - (2) The third party SNT affords the parents, grandparents, or other family (or non family) members the opportunity to preserve the beneficiary's public benefits and to supplement those benefits.
 - (3) In addition, the third party SNT provides for the proper management of the gift to the beneficiary with disabilities for the beneficiary's entire lifetime.
 - (4) At the beneficiary's death, the property can pass as designated in the will or trust agreement or by exercise of a testamentary non-general power of appointment.
- b. A self settled SNT differs from third party SNT in that a self settled SNT contains the resources of an individual with disabilities and must contain a mandatory Medicaid payback provision.¹⁰
- c. A third party SNT can be created by a revocable inter vivos trust agreement, an irrevocable inter vivos trust agreement, or

⁹If the beneficiary with disabilities does not have the legal authority to revoke the trust or direct the use of the trust for his or her own support, then the trust is not a resource for SSI eligibility purposes. Therefore, a Third Party SNT should not have a support and maintenance distribution standard. See the Social Security Administration's ("SSA") Program Operations Manual ("POMS"), POMS SI 01120.200.

¹⁰North Carolina also requires that the trust contain a payback provision not only upon death but also upon the termination of the trust for other reasons. North Carolina MA-2230 XI.C.3.e.

a will. Generally, a separate inter vivos trust agreement is used to allow other family members (and friends) to use the third party SNT in their estate plans. A d(4)(A) or d(4)(C) SNT must be created by an irrevocable inter vivos trust agreement.

- d. If a spouse wants to create an SNT for the benefit of a surviving spouse who is receiving Medicaid benefits, the SNT must be a testamentary trust contained in a will. A spouse who is receiving Medicaid benefits cannot be disinherited by the other spouse, because the Medicaid recipient spouse is required to pursue his or her augmented estate rights, otherwise the Medicaid recipient spouse will be deemed to have made a gift of the elective share, resulting in a period of ineligibility for Medicaid. The elective share can be satisfied: (i) by giving the elective share amount of the deceased spouse's estate directly to the Medicaid recipient spouse or (ii) by distributing the elective share amount of the deceased spouse's estate to a testamentary SNT allowing distribution of income and principal for the surviving spouse's benefit.

- e. If the parents, grandparents or friends execute a third party SNT, they can designate the trustee of the SNT as the beneficiary of life insurance policies, annuities, or as a payable-on-death (POD) or transfer-on-death (TOD) recipient of bank and brokerage accounts. The third party SNT can also be named as the beneficiary of qualified plans; in that instance the drafting attorney will want to ensure that the SNT qualifies as a designated beneficiary by naming identifiable individuals as remainder beneficiaries. This allows taxes to be deferred by having the qualified plan assets distributed (i.e. "stretched out") over a longer period of time. Although third party SNTs normally permit trustees to retain income (with undistributed income being added annually to principal), trustees should be cautious about retaining qualified plan benefits (which are typically taxable as "Income In Respect of a Decedent" under IRC section 691), since any qualified plan distributions retained in the third party SNT could be subject to higher (i.e., compressed) income taxation. Another solution for qualified plans is to name a charitable remainder trust as the designated beneficiary of the qualified plan, and then have the charitable remainder trust make its annual payment to the third party SNT. The payments from the

charitable remainder trust to the SNT are treated as payments to an individual under IRC section 664. This plan could work well when a large qualified plan is the primary source of funding for the third party SNT. The parents or grandparents should also prepare a letter of intent that details their intentions and desires for the disabled beneficiary's future.

8. SNTs are also sometimes called supplemental needs trusts. However, the Social Security Administration ("SSA") refers to d(4)(A) and d(4)(C) trusts as special needs trusts. Some practitioners refer to third party SNTs as "supplemental needs trusts," and refer to first party SNTs (i.e., self-settled SNTs) as "special needs trust." Local practice customs generally determine the nomenclature used by a practitioner when describing a SNT.

B. Purpose.

1. The purpose of the self settled SNT is to avoid:
 - a. the imposition of a period of ineligibility for SSI¹¹ or Medicaid because of the transfer of the resources to the trust, and
 - b. the treatment of the trust as a resource for SSI or Medicaid eligibility purposes.
2. The purpose of the third party SNT is to permit a parent, grandparent or other person to provide for the needs of a person with a disability which are not being met by public benefits.

C. Uses and Misuses.

1. The following are typical situations in which a self settled SNT is used to protect the SSI or Medicaid benefits of an individual with disabilities:
 - a. Tort recovery or settlement
 - b. Inheritance (i.e., ineffective or no estate planning by the disabled individual's family)

¹¹42 U.S.C. §1382b(c) (2008).

- c. Equitable distribution or alimony
2. Because of the Medicaid payback requirement for d(4)(A) and d(4)(C) SNT's, the parents, grandparents or other family members of a person with disabilities should not make gifts to the person with a disability using a d(4)(A) or d(4)(C) SNT. Instead, they should make the gift to a third party SNT.
3. Many cases have been observed where the estate planning attorney mistakenly used a d(4)(A) SNT or recommended a d(4)(c) SNT rather than a third party SNT. The improper use of the d(4)(A) or d(4)(c) SNT could result in the unnecessary repayment of Medicaid benefits to the state and a potential malpractice action against the drafting attorney.

II. MALPRACTICE FOR FAILURE TO PRESERVE PUBLIC BENEFIT ELIGIBILITY

A. Personal Injury Case

1. Christina Grillo settled a personal injury case in 1991 for a lump sum upon the advice of her personal injury attorney. She later sued the attorney and guardian ad litem for malpractice. She alleged that the defendants: (1) failed to consult competent experts concerning a structured settlement and (2) failed to plan to preserve her SSI and Medicaid eligibility. Ms. Grillo alleged that structured settlement with a d(4)(A) SNT would have protected her personal injury settlement from dissipation, provide tax benefits and protected her SSI and Medicaid benefits. The case was settled by all defendants for a combined sum of \$4.1 million.¹²
2. Edith Saunders, the conservator for James A. Saunders III (Jamie) settled a personal injury action on Jamie's behalf. As a part of the application to compromise and settle the claim, the conservator requested that the net settlement amount be placed in a d(4)(A) SNT for Jamie to preserve his Medicaid eligibility. The State of Connecticut objected. The Supreme Court of Connecticut rejected the attorney general's argument that the conservator should spend down

¹²*Grillo v. Petiete et al.*, 96-145090-92, 96th Dist. Ct., Tarrant Cty., Texas, and *Grillo v. Henry Cause*, 96-167943-96, 96th Dist. Ct., Tarrant Cty., Texas. See also *French v. Glorioso*, 94 S.W.3d 739 (Tex. Ct. App. 2002) which demonstrates the potential for malpractice liability for failure to advise clients about the impact of a settlement on public benefits eligibility.

all of Jamie’s assets and then re-apply for Medicaid assistance. The court ruled: “By contrast, with the creation of the trust, Jamie will retain his Medicaid eligibility and Saunders (the conservatrix) can provide for his supplemental needs from the trust assets, while Medicaid provides for his basic medical care. Therefore, not only is the latter course of action clearly better for Jamie, *it may be fairly stated by failing to follow it, the probate court, and Saunders could be deemed to be in dereliction of their duties to Jamie* (italics added).”¹³ This duty requires the fiduciary of an estate and indirectly, the trial lawyer, to protect the client’s settlement.

3. In 2008, Oast & Hook was asked to assist a personal injury plaintiff who lost his Medicaid eligibility as the result of a Workman’s Compensation settlement. As a part of the settlement, the personal injury attorney had a “self directed” Medicare Set-Aside Arrangement (WCMSA)¹⁴ created to protect the plaintiff’s Medicare eligibility. The funds were deposited into a bank account. However, the personal injury attorney over looked his client’s Medicaid eligibility. Since the claimant had control of the custodial account, the Virginia Department of Social Services determined the custodial account was a resource¹⁵ for Medicaid eligibility and terminated the client’s Medicaid benefits. Oast & Hook corrected this error by assisting the client with the creation of a d(4)(c) SNT and the transfer of the funds in the custodial account to the SNT.
 - a. North Carolina considers the gross amount of worker’s compensation benefits less the expenses incurred which were necessary for entitlement as countable income. The money is countable from the time it is received, for example, all at once

¹³*Dept. of Social Services v. Saunders*, 724 A.2d 1093, 247 Conn. 686 (1999).

¹⁴When a worker’s compensation claim is settled for a lump sum, a WCMSA is often required to protect the worker’s Medicare Eligibility. The Centers for Medicare and Medicaid Services (CMS) has issued FAQ on July 11, 2005 concerning the relationship between WCMSA and SNTs. Within the answer to question 13, CMS stated that a WCMSA is not subject to any special treatment under Medicaid resource rules.

¹⁵Virginia Medicaid Manual, §M1140.500.

if received in a lump payment, or montly, if received monthly.¹⁶

4. A trial attorney has the duty to ensure his client is informed about the options of structured settlements, trusts and the effect of the judgement or settlement on the client's public benefits eligibility.¹⁷

B. Estate Planning

1. In 2000, an attorney was retained to draft the will that left a significant sum to the testatrix's sister who resided in a nursing home. The Medicaid program was paying for the sister's care.
2. After the testatrix's death, the sister was disqualified for Medicaid assistance, had to spend down the inheritance and reapply for Medicaid assistance.
3. The Supreme Judicial Court of Maine held that the attorney "... could and should have drafted a 'Supplemental Needs Trust' for ...[the testatrix's sister], thereby avoiding the Medicaid spend down..."
4. On October 25, 2002, the court suspended the drafting attorney's license to practice law because of his failure to create the special needs trust and for other reasons.¹⁸

III. AVAILABLE PUBLIC BENEFITS FOR PERSONS WITH DISABILITIES

- A. Comprehensive Plan. The attorney must consider and incorporate the public benefits that are available to the disabled person into an appropriate special needs plan. Each of these public benefits have different eligibility rules and different sets of covered services. Some of these benefits are not based on financial need and some of them have financial eligibility requirements.

¹⁶See MA-2250-VIII.G. for further details on North Carolina's medicaid requirements on worker's compensation benefits.

¹⁷See *After the Judgment*, Ellen S. Pryor, 88 Va. L. Rev. 1757 (December 2002) and *How to Protect Aged Injury Victims: Implications for Trial Lawyers*, Jason D. Lazarus, NAELA Journal, Vol. 4, 2008, Number 2.

¹⁸*Board of Overseers of the Bar v. Ralph W. Brown, Esq.*, Me. Sup. Jud. Ct. Docket No. BAR-01-6 (October 25, 2002).

Although SNT's are not necessary to protect those benefits that do not have financial eligibility rules, SNTs will protect the eligibility for some, but not all, of the programs with benefits that are based on financial need.

B. Benefits Not Based on Financial Need

1. Social Security Disability Insurance

a. A person with disabilities is entitled to Social Security Disability Insurance ("SSDI") benefits if he or she:

- (1) is under full retirement age,
- (2) has at least 20 credits in the 40 quarter period ending with the quarter in which the individual became disabled (20/40 rule), and is fully insured,¹⁹
- (3) is disabled,²⁰
- (4) files an application for benefits, and
- (5) establishes a waiting period of five consecutive months beginning with a month in which the worker was both insured and disabled.

b. SSDI benefits may also be available based on the record of a living parent (Social Security Dependent's Benefits) or a deceased parent (Social Security Survivors' Benefits) parent. Children who became disabled before age 22 and have remained continuously disabled may draw benefits on the record of a disabled, deceased, or retired parent as long as the

¹⁹Social Security Handbook, http://www.ssa.gov/OP_Home/handbook/ssa-hbk.htm, §207. See §203 for the definition of fully insured (generally one quarter for each year after attaining the age of 21 up to a maximum of 40 quarters) and §208 for a special exception to the 20/40 rule for workers disabled before age 31.

²⁰To be disabled within the meaning of the Social Security Act, the individual must have a severe, medically determinable physical or mental impairment which has or is expected to last for one year or to result in death. In addition, the impairment must make the individual unable to engage in "substantial gainful activity." 20 CFR § 404.1505 for SSDI and 20 CFR § 416.905 for SSI.

child is disabled and unmarried. These benefits are often called Childhood Disability Benefits ("CDB's").²¹ A CDB beneficiary who marries another SSDI recipient generally will not lose benefits. The CDB beneficiary should contact the local Social Security Office before marrying to determine the effect of the marriage on his or her benefits and should not engage in "substantial gainful activity."

- c. SSDI monthly benefits are based on the worker's primary insurance amount ("PIA") which is based on the worker's indexed monthly earnings. The worker's benefit is based on a 100% of the PIA. A CDB of a worker is entitled to 50% of PIA and, if the worker is deceased, this increases to 75%. A spouse's benefit is also available.
- d. There are no resource or income limits for SSDI eligibility. However, if the individual's *earned* income in 2009 exceeds \$980 a month (after deducting the cost of impairment-related work expenses), the person will likely not be considered disabled and therefore may not be eligible for SSDI benefits.
- e. Disability payments from private sources, VA benefits, SSI, and state and local government benefits²² do not affect SSDI benefits. Workers' compensation benefits may reduce SSDI benefits if the total amount of both benefits exceed 80% of average current earnings before disability. Additionally, lump-sum workers' compensation payments in addition to or instead of a monthly payment can effect SSDI benefits.²³

2. Medicare.²⁴

- a. Medicare is a federal health insurance program. SSDI

²¹Formerly called Disabled Adult Child ("DAC") benefits.

²²If Social Security taxes are deducted from the state or local government benefits.

²³<http://www.ssa.gov/pubs/10018.pdf>

²⁴The 2009 Medicare Handbook, Stein and Chiplin, publish by Wolters Kluwer, is an excellent source of information about Medicare. Another important source of information is the CMS website at www.medicare.gov

beneficiaries are entitled to Part A Medicare benefits after 24 months of qualified disability, one month waiting period for a person disabled with ALS (a.k.a. “Lou Gehrig’s Disease effective 7/1/2001) of qualified disability and no waiting period for people on kidney dialysis.

- b. Medicare Part A covers inpatient hospital services, home health, and hospice benefits. *It also pays for a very limited amount of Skilled Nursing Home care but not custodial care.*
- c. SSDI beneficiaries who are eligible for Medicare Part A benefits may enroll for Medicare Part B benefits but must pay a premium of \$96.40 per month in 2009. Part B benefits cover physicians’ charges.
- d. Medicare generally does not pay the entire cost of hospital stays and physicians services. In addition there are deductibles and co-pays.
- e. Medicare Part D provides Medicare beneficiaries with limited assistance to pay for prescription drugs. Part D coverage is voluntary. A beneficiary may purchase Part D coverage if he or she has Medicare Part A or Medicare Part B. The Part D premium averages about \$37 per month in 2008. There are deductibles and co-pays.
- f. Medicare provides alternatives to the traditional fee for service care option provided by Parts A, B and D. These services are known as Medicare Advantage. The Medicare Advantage program delivers Medicare services through HMOs, PPOs, and HSAs.
- g. There are no resource or income limits for Medicare eligibility. However, if the Medicare benefits are a result of the person receiving SSDI and the SSDI recipient's earned income exceeds the Substantial Gainful Activity limit (\$980 per month or \$1640 for blind individuals in 2009) (after deducting the cost of impairment related expenses),the disabled person may not be eligible for SSDI and therefore

lose his or her SSDI linked Medicare benefits.²⁵

- h. There are gaps in the Medicare coverage in the forms of deductibles and co-pays. Medigap insurance is provided by private health insurance companies to supplement Medicare coverage and sometimes to cover services not covered by Medicare. There are 12 standardized Medigap policies (plans with letters A through L). Pursuant to federal law, all Medicare beneficiaries have an open enrollment period during the first 6 months if they are both (i) at least 65 years of age and (ii) enrolled in Medicare Part B.
 - i. About 7.5 million people are eligible for both Medicare and Medicaid. They are known as “dual eligibles.” For dual eligibles, Medicaid pays some or all of the Medicare premiums, deductibles and co-pays and extends coverage to services not covered by Medicare, including long term care.
3. Special Education.²⁶ The federal law known as the Individuals with Disabilities Education Act ("IDEA")²⁷ and related state regulations provide that a free appropriate public education will be provided to all children with disabilities, age 2 to 21 (services may be provided from age 0 to 3 by other state agencies and over the age of 21 by some states²⁸). IDEA provides that the state must provide, at no cost,

²⁵See <http://www.ssa.gov/OACT/COLA/sga.html>

²⁶An excellent resource for Special Education law is the Wrightslaw website: <http://www.wrightslaw.com/>

²⁷20 U.S.C. §1400 et seq. The IDEA of 1997 was reauthorized and amended in 2004 by the Individuals with Disabilities Education Improvement Act ("IDEIA"). The IDEIA maintains the basic principles of IDEA, a free appropriate public education for all students with disabilities, in the least restrictive environment, however, there are many changes and modifications to the Individualized Education Plan ("IEP") process and other aspects of the identification and evaluation of students with disabilities.

²⁸For example in 2008 Michigan provides special education to students until the age of 26. However, if the student receives a “regular” (i.e., non-special education) diploma prior to age 26, the Michigan school district has the discretion to terminate post-high school special education services to the recipient of the regular diploma - an unwelcome surprise to many an unsuspecting student and parent.

appropriate public education that meets the unique needs of students with disabilities, in the least restrictive setting, which in most cases means “mainstreaming” (i.e. including) the child into the regular classroom. If no appropriate public facility is available, the education must be provided in a private school at no cost to the parents.

- a. The local school agency ("LEA") must conduct ongoing efforts to bring students with disabilities into school.
- b. To determine what is appropriate for the student, the LEA must devise an individualized education program ("IEP") for every student with disabilities. The parents of the student are invited to participate in the formulation of the IEP.
- c. If the parents disagree with the IEP, they may request a due process hearing. If satisfaction is not obtained at the hearing, the parents may bring suit in state or federal court. The LEA must provide safeguards to support and protect the parents and students rights to notice and due process if services are initiated, altered, or terminated.
- d. When the student reaches age 18, the parent’s rights to participate in the development of and implementation of the IEP or in challenging the IEP “transfer” to the student, unless one of the following actions is taken²⁹:
 - (1) The adult student is declared legally incompetent by a court and a representative has been appointed by the court to make decisions for the student.
 - (2) The adult student designates, in writing, by a (durable) power of attorney, another adult to be the student’s agent to participate and make decisions concerning the student’s educational program.
 - (3) The adult student is certified as unable to provide informed consent and the LEA appoints an educational representative.

²⁹For example, see the Virginia Department of Education’s Transfer of Rights rules at http://www.doe.virginia.gov/VDOE/Instruction/Sped/transfer_rights.pdf which contains sample forms.

- e. Students with disabilities are held accountable to the same content standards as other students.³⁰
4. Section 504 of the Rehabilitation Act of 1973³¹
- a. Section 504 protects qualified individuals with disabilities from discrimination based on their disability.
 - b. The nondiscrimination requirements apply to employers and organizations that receive financial assistance from any Federal department or agency. These organizations and employers include many schools, hospitals, nursing homes, mental health centers and human service programs.
 - c. Section 504 forbids organizations and employers from excluding or denying individuals with disabilities an equal opportunity to receive program benefits and services. It defines the rights of individuals with disabilities to participate in, and have access to, program benefits and services.
 - d. Section 504 protects qualified individuals with disabilities. Individuals with disabilities are defined as persons with a physical or mental impairment which substantially limits one or more major life activities. People who have a history of, or who are regarded as having a physical or mental impairment that substantially limits one or more major life activities, are also covered. Major life activities include caring for one's self, walking, seeing, hearing, speaking, breathing, working, performing manual tasks, and learning. Some examples of impairments which may substantially limit major life activities, even with the help of medication or aids/devices, are: AIDS, alcoholism, blindness or visual impairment, cancer, deafness or hearing impairment, diabetes, drug addiction, heart disease, and mental illness. In addition to meeting the above definition, for purposes of receiving services, education or training, qualified individuals with

³⁰No Child Left Behind Act of 2001. Pub. L. No. 107-110.

³¹29 USC §§ 705(20) and 794.

disabilities are persons who meet normal and essential eligibility requirements.

- e. Although the Section 504 definition of disability is broader than the definition in IDEA, the services are more limited. The covered organization or employer is only required to ensure the disabled person gets the same services as non-disabled persons while IDEA students must get certain services whether or not non-disabled students receive those services.
5. Americans with Disabilities Act ("ADA"). The ADA protects individuals with disabilities from discrimination in the areas of employment, housing, public accommodations, education, transportation, communication, recreation, institutionalization, health services, voting and access to public services.³²
 6. Consolidated Omnibus Budget Reconciliation Act ("COBRA")³³
 - a. Employers providing group or self-funded health coverage are required to offer terminated employees the right to buy continued health coverage (identical coverage). Government, church and small employers (fewer than 20 employees) are exempt from COBRA.
 - b. Terminated employees (voluntary and involuntary) and dependents are entitled to up to 18 months of continued coverage.

³²42 USC § 1201(a)(3). The ADA Amendments Act of 2008 was enacted into law on September 26, 2008. It overturns three 1999 and a 2002 decisions of the US Supreme Court. The 2008 Act amends the ADA's definition of "disability" to apply to impairments that are dormant or in remission or that can be ameliorated or mitigated. Also, it makes it easier for an individual to demonstrate being "regarded as" disabled. The ADA will now also apply to impairments that substantially limit only one major life activity. And "major life activity" will now include major bodily functions such as cell growth, endocrine functions, neurological functions, digestive functions, respiratory functions, and reproductive functions. In other words, individuals with fully managed diabetes or controlled asthma or fertility difficulties will now be protected under the ADA. These amendments will significantly broaden the protections afforded by the ADA, require greater employer vigilance in handling employees with alleged disabilities, and probably lead to increased ADA litigation.

³³Pub. L. No. 99-272 signed into law on April 7, 1986.

- c. If either the employee or a covered family member is disabled (within meaning of the Social Security Act) within 60 days of the triggering event, the period of continuation coverage can be extended by 11 months (for a total of 29 months).³⁴
 - d. Continuation coverage is not automatic and must be elected by the terminated employee.
 - e. The cost of the continuation coverage may be passed on to (i.e., be paid by) the qualifying beneficiary, but not to exceed 102 percent of the cost of the plan.
7. Health Insurance Portability Accountability Act (HIPAA)³⁵
- a. At the conclusion of the continuation coverage under COBRA, a disabled employee who has been covered by the employer’s group policy for 12 months or more may purchase an individual health plan without preexisting conditions clause and no medical underwriting.
 - b. In lieu of electing COBRA, a disabled employee who has been covered by the employers group policy for 12 months or more is terminating employment may obtain an “guaranteed issue” health care policy.
8. Military and Civil Service Survivor Benefits for Adult Children with Disabilities
- a. Military Survivor Benefits (SBP) may be available if the military member selected spouse and children coverage, or children-only coverage (not automatic as the Federal Civil Service benefits are). If the member elects spouse and children coverage, the child will not receive payments until the surviving spouse becomes ineligible because of remarriage before age 55 or death. Provides 55% of the base amount at the time of the retiree’s death, divided by all eligible children. The payments end if the child marries or is

³⁴This additional 11 months permits a totally disabled employee to extend coverage until the employee qualifies for Medicare.

³⁵29 U.S.C. § 1181(a).

no longer disabled.³⁶ If the child is mentally incompetent, payments must be made to a court-appointed guardian, fiduciary, or representative payee (as determined by the Defense Finance and Accounting Service) of the child.³⁷

- (1) SBP Payments to the disabled child are income for SSI eligibility purposes. If this income causes the child to lose SSI eligibility, the child, in most cases, will lose Medicaid coverage. Although the disabled child will retain TRICARE healthcare coverage, the loss of Medicaid will result in the loss of long-term support benefits. TRICARE does not provide the same benefits as Medicaid.
- (2) Since the disabled child is the beneficiary of the SBP, the child will be deemed to have received the payments even if they have been assigned to an SNT.
- (3) If the military member has died and the disabled child is losing benefits as a result of the SBP payments, can they be canceled? Unfortunately, the answer is no.
- (4) What planning options are available for military member?
 - (a) The first option is to not elect SBP or to select a *spouse only* SBP benefit.
 - (b) If the military member has already made an SBP election including a child, he or she should apply to the Board of Correction of Military Records to modify the SBP election.³⁸ This option must be completed while the retiree is alive.

³⁶See 10 USC 1447 (11) for definition of dependent child: “...(III) incapable of self support because of a mental or physical incapacity existing before the person’s eighteen birthday or incurred on or after that birthday, ...”

³⁷<http://www.military.com/benefits/survivor-benefits/survivor-benefit-plan-explained> and <http://www.military.com/benefits/survivor-benefits/survivor-benefit-plan-faqs>.

³⁸Use DD Form 149

- b. TRICARE is a health benefit program for all seven uniformed services. TRICARE eligible persons include active duty and retired service members and their spouses and unmarried children. Unmarried children of active duty or retired service members who have died are also TRICARE eligible. Children over 21 who are severely disabled and the condition existed prior to the child's 21st birthday, or if the condition occurred between the ages of 21 and 23 while the child was a full-time student are eligible.³⁹
- c. Civil Service Survivor Benefits are available for an unmarried child over age 18 who is incapable of self support because of a mental or physical disability that began before age 18. The child may receive the benefit even if a widow(er) is also receiving a survivor benefit. Children receiving a civil service survivor annuity are also eligible for federal employee group health benefits if the federal employee had family coverage at the date of his or her death.⁴⁰
 - (1) If a Survivor benefit is elected, survivor benefits for an eligible child are automatic.⁴¹
 - (2) See discussion above concerning Military Survivor Benefits concerning the effect of survivor benefits on SSI and Medicaid eligibility for disabled children.

C. Benefits Based on Financial Need

- 1. Supplemental Security Income ("SSI").
 - a. SSI is a federal welfare program that provides a minimum level of income for some needy persons. To be eligible for SSI a person must be:

³⁹www.tricare.osd.mil (TRICARE Website).

⁴⁰www.opm.gov/retire (U. S. Office of Personnel Management - Federal Retirees)
www.opm.gov/insure/handbook/fehb29.asp (Federal Employees Health Benefits Handbook, Family Members).

⁴¹<http://www.opm.gov/retire/html/faqs/faq2.asp#5>

- (1) age 65 or older, or blind, or disabled;
 - (2) a U.S. citizen (with limited exceptions); and
 - (3) not a resident of a public institution.
- b. To be eligible for SSI benefits, the 2009 monthly federal benefit rate for unmarried persons is \$674 and for a couple is \$1011.
- c. “Deemed” income is income of another attributed to the claimant. Deemed income is an issue when the minor child lives with an ineligible parent. Deeming stops applying in the month following the child’s 18th birthday.
- (1) Income is anything received in cash.
 - (2) The following cash items are specifically excluded:
 - (a) The first \$20 of most income received in a month.
 - (b) The first \$65 of work earnings received in a month, and one-half of work earnings over \$65.
 - (3) If an SSI recipient receives items of food or shelter in-kind (commonly referred to as “in-kind support and maintenance” (“ISM”)), the Social Security Administration (“SSA”) will treat those items as income dollar for dollar subject to the lesser of: (i) the amount ISM provided, or (ii) 1/3 of the federal (SSI) benefit rate plus the unearned income disregard of \$20, for a total of \$245 in 2009. [$\$674 \times 1/3 = \$225 + 20 = \$245$].⁴²
- d. An unmarried individual can have no more than \$2,000 of countable resources. Generally countable resources include cash, liquid assets, and any real or personal property that an

⁴²For example, assume that a disabled child is living with his or her parents. The maximum reduction in the child’s SSI check as a result of ISM is \$232.

individual owns (or has the right to liquidate) and could convert to cash to use for his or her support and maintenance⁴³.

- e. Non-countable resources include:⁴⁴
 - (1) A home owned and occupied by the person with a disability, or if institutionalized, in many states, a home the person intends to return to.
 - (2) One automobile per household is excluded regardless of the value if it is used for transportation of the eligible individual or a member of the eligible individual's household.
 - (3) Household goods and personal effects with a total value of less than \$2,000.
 - (4) Pre-paid irrevocable funeral and burial arrangements, regardless of value.
 - f. Transfers of resources for less than fair market value within 36 months of an application for SSI will result in the imposition of a period of ineligibility (up to 36 months) determined by dividing the uncompensated value of the amount transferred by the federal benefit rate plus any state supplement benefit rate. [2009 formula example: Amount of uncompensated value ÷ (\$674+ 20) = months of SSI ineligibility.]
2. Medicaid. Medicaid is a joint federal and state funded program to provide medical services to the Aged, Blind and Disabled who are needy.
- a. The U.S. Department of Health and Human Services approves state Medicaid plans.
 - b. The federal government provides about one-half of the funding and delegates the administration of each state's plan to the state.

⁴³20 CFR §416.1202 (2008).

⁴⁴See POMS §SI 01130 for a list of non-countable resources.

- (1) The individual state Medicaid programs are subject to both federal and state regulation.
 - (2) States have three options for the determination of Medicaid eligibility.⁴⁵
 - (a) 209(b) states use at least one eligibility criterion more restrictive than the SSI program. States have elected this option may not use more restrictive standards than those in effect in January 1, 1972, and must provide for Medicaid income spend down so that individuals may reduce their income to the income eligibility level.⁴⁶
 - (b) SSI states that use the SSI eligibility criteria for Medicaid but make their own independent Medicaid determinations.⁴⁷ The individual is eligible for Medicaid if he or she is entitled to at least \$1 per month of SSI benefits.
 - (c) 1634 States use SSI eligibility criteria and have entered into an agreement with the SSA for SSA to make Medicaid eligibility determinations.⁴⁸ The individual is automatically (i.e. "categorically") eligible for Medicaid if he or she receives at least \$1 per month of SSI benefits.
- c. Benefits Provided. Medicaid provides many services that are required or desperately needed by persons with disabilities or special needs.

⁴⁵POMS § SI 01715.010.

⁴⁶The 209(b) states are: Connecticut, Hawaii, Illinois, Indiana, Minnesota, Missouri, Nebraska, New Hampshire, North Dakota, Ohio, Oklahoma, Oregon, Utah and Virginia.

⁴⁷The SSI states are Alaska, Idaho, Kansas, Nebraska, Nevada, Oregon, and Utah.

⁴⁸The 1634 States are the remaining states. The agreement between the state and SSA is authorized by Section 1634 of the Social Security Act (42 USC §1383c).

- (1) The federal Medicaid statute requires the states to pay for certain listed medical services.⁴⁹ These include:
 - (a) Inpatient hospital services
 - (b) Outpatient hospital services
 - (c) Physician services
 - (d) Physical therapy
 - (e) Prescribed drugs
 - (f) Skilled and intermediate nursing services
 - (g) Home and community care for individuals with disabilities
 - (h) Community support living arrangement services
 - (i) Personal care services
 - (j) Case Management services
 - (k) Emergency and non-emergency medical transport.

- (2) Some states have sought and have been granted special waivers to provide Medicaid services to individuals who live at home rather than in an institution. Waiver services can provide the following home and community based services:⁵⁰
 - (a) Case Management
 - (b) Homemaker services

⁴⁹42 USC §§1396a(A)(10)(A) and 1396a(a)(10)(C) as well as 42 CFR §§440.210, 440.220 and 440.230 (2008).

⁵⁰42 CFR §§441.300 et seq. (2008).

- (c) Home health aids
 - (d) Personal care services
- (3) State Medicaid Plans must provide for home health care for all persons entitled to nursing facility services.
 - (4) Medicaid additionally provides Medicare cost-sharing coverage for poor Medicare Beneficiaries (QMBs), and premium payments for near poor Medicare beneficiaries (SLMBs), Qualified Disabled and Working Individuals (QDWIs) and Qualified Individuals (QIs). Collectively, these programs are called the Medicare Savings Programs (MSPs).⁵¹
3. Medicare Part D Low-Income Subsidy (LIS). Some form of LIS is available to help pay the cost of Medicare Part D drug coverage for Medicare beneficiaries with incomes up to 150 percent of the federal poverty limit (FPL). Subsidies vary according to income, Medicaid status and institutional status.⁵²
 4. Group Health Insurance. The health insurance laws of some states⁵³ provide that the coverage of a dependent child shall not terminate upon the attainment of a specified age when the child is and continues to be both:
 - a. incapable of self support by reason of a disability, and

⁵¹See Chapter 10 of 2009 Medicare Handbook, Stein and Chiplin, Wolters Kluwer for a discussion of the benefits and eligibility rules for MSPs.

⁵²See Chapter 11 of 2009 Medicare Handbook, Stein and Chiplin, Wolters Kluwer, for a discussion of the benefits and eligibility rules for LISs.

⁵³For example, see Virginia Code §38.2-3409. This statute requires proof of the incapacity and dependency be furnished to the insurer by the policy owner within 31 days of the child's attainment of the specified age. Subsequent proof may be required annually thereafter. The insurer may charge an additional premium for any continuance of coverage beyond the specified age. The premium must be determined on the basis of the class risks applicable to the child. See also, N.C. Gen. Stat. § 58-51-25 and Michigan Compiled Laws section 550.1410 which have similar requirements.

- b. is dependent upon⁵⁴ the policy owner for support.
5. Housing Choice Voucher Program ("Section 8")
- a. Housing is one of the greatest concerns of the individuals with disabilities and their families.
 - b. Section 8 is a federal subsidy to assist with monthly housing costs. Under Section 8 the household pays a portion of monthly housing costs based on the income of the household. This portion is usually equal to 30 percent of the household's monthly adjusted income.
 - c. Subsidies are administered by a Public Housing Agency ("PHA") under a contract with the U.S. Department of Housing and Urban Development ("HUD"). A PHA must conduct outreach within its jurisdiction to potentially eligible households when accepting Section 8 applications.
 - d. To be eligible for the Section 8 program, applicants must:
 - (1) not have income that exceeds the applicable income limit,⁵⁵
 - (2) be a citizen or a non-citizen with "eligible immigration status," and
 - (3) be in good standing with the PHA.
 - e. The Section 8 program does not specifically exempt d(4)(A) or d(4)(C) SNTs. However, the Section 8 program has its own rules relating to irrevocable trusts⁵⁶:
 - (1) Generally a Section 8 applicant must report all income earned by his or her assets or 2% per year if no income is earned on an asset.

⁵⁴In light of the dependency requirement, a trust created for the disabled dependent should be a SNT.

⁵⁵The income limits used to determine eligibility vary by program from 30% of median income for the Area (where the applicant resides) to 95%.

⁵⁶HUD Handbook 4350.3 REV-1, Section 5-7, www.hudclips.org.

- (2) If no family member has access to either the principal or income of the trust at the current time, the trust is not included in the calculation of income from assets. Therefore, a d(4)(A) SNT should not be considered an asset if no family member who resides in the Section 8 housing is a trustee of the trust.
- (3) Distributions from the trust on a recurring basis to the applicant (other than for groceries) will be considered in the applicant's annual income. Temporary, nonrecurring or sporadic income (including gifts) is not counted.
- (4) Generally, the creation of the trust is considered an asset disposition for less than fair value and the applicant must count the assets transferred to the trust for eligibility purposes for two years. However, there is an important exception for d(4)(A) or d(4)(C) SNTs funded with the proceeds of a litigation settlement or judgment. These assets are excepted from the two-year rule.

6. Veterans Administration Pension ("VA Pension")⁵⁷

- a. A VA pension is payable to a veteran if:
 - (1) he or she was discharged from service under other than dishonorable conditions, and
 - (2) he or she served 90 days or more of active duty with at least one day during a period of war time, and
 - (a) countable family income is below a yearly limit and family assets are below an age adjusted amount, and
 - (b) he or she is permanently and totally disabled, or age 65 or older.
- b. A self settled SNT is includable in the claimant's net worth

⁵⁷For more information about Veterans Administration visit the Oast & Hook VA Pension website: <http://www.veteransbenefitsva.com/>

for purposes of determining eligibility for a VA pension.⁵⁸

IV. WHAT ARE THE ALTERNATIVES TO A SNT?

A. Consider the alternatives to a SNT.

1. Before implementing a SNT, you should consider whether the trust is necessary. A SNT is not always necessary or the right answer!
2. The cost of creating and funding a "typical" SNT is frequently about \$5,000. Thereafter the trust will incur administration expenses, including trustee's fees, investment fees, and tax return preparation fees. These costs may be excessive in relation to the amount in question.
3. The beneficiary may not need SSI, Medicaid or Public Housing.⁵⁹

B. Alternatives to a d(4)(A) or d(4)(C) SNT

1. Purchase exempt resources, such as motor vehicle or home.
2. Pay off debt, including mortgages and credit card debt.
3. Prepay bills.
4. Give up needs-based benefits and rely on the individual's resources, income and non needs-based benefits.

C. Alternatives to a Third Party SNT

1. Disinheritance. This strategy was frequently used prior to the advent of SNT's. It is not commonly used today.

⁵⁸VAOPGCPREC 33-97 (August 29, 1997), "Assets transferred by a legally competent claimant, or by fiduciary of a legally incompetent one, to an irrevocable "living trust" or an estate-planning vehicle of the same nature designed to preserve estate assets by restricting trust expenditures to the claimant's "special needs," while maximizing the use of governmental resources in the care and maintenance of the claimant, should be considered in calculating the claimant's net worth for improved-pension purposes."

⁵⁹In a New York case the court refused to order the establishment of a special needs trust because it believed that the income available to the child from the tort settlement exceeded her monthly care needs. *Matter of LaBarbera*, (Sup. Ct. Suffolk N.Y. April 26, 1996).

2. Gifts to third parties under a moral obligation to assist the person with a disability. This strategy is not recommended since it leaves the disabled person totally at risk.

D. Current Developments

1. During 2008, the following bills have been referred to a committee in the US Congress

- a. H.R. 2370 - Financial Security Accounts

- (1) Amends the IRC to establish tax-exempt financial security accounts for individuals with disabilities to pay for certain expenses of such individuals.
- (2) The account is not to be deemed a resource or income for SSI or Medicaid eligibility.

- b. S. 2741 - Disability Savings Act

- (1) Amends the IRC to allow a tax exemption for disability savings that have a value of \$250,000 or less and are established for beneficiaries under the age of 65 who are blind or disabled.
- (2) Allows tax-free distributions from such accounts for certain services
- (3) Allows tax credits for contributions of up to \$2000 made to such an account
- (4) Permits such accounts to be disregarded in determining eligibility for Medicaid and certain other means-tested federal programs

- c. S. 2743 - Financial Security Accounts

- (1) Amends the IRC to establish tax-exempt financial security accounts for individuals with disabilities to pay for certain expenses of such individuals.
- (2) Allows individual taxpayers a tax deduction, up to \$2000 per year, for cash contributions to such accounts.

- (3) Disregards these accounts in determining eligibility for Medicaid benefits.
2. It is not clear that contributions to these accounts will be exempt from the SSI and Medicaid asset transfer rules.
3. It is likely that similar bill(s) will be introduced into Congress during 2009.
4. These accounts will likely serve as alternatives to d(4)(C) SNTs and structured settlements.

V. DRAFTING A d(4)(A) SPECIAL NEEDS TRUSTS⁶⁰

A. POMS Requirements.

1. The Social Security Administration ("SSA") publishes the Program Operations Manual ("POMS") as its publicly available operating instructions for processing Social Security claims. Although these instructions are not the product of formal rule making, the Supreme Court has held that the POMS' "warrant respect."⁶¹
2. The POMS contain an action chart⁶² to determine whether a trust is in compliance with the d(4)(A) SNT rules. For a d(4)(C) SNT, the attorney representing the disabled individual will want to contact the non-profit organization sponsoring the trust to ensure it complies with POMS requirements.
3. The POMS' action steps for a trust to qualify as a d(4)(A) SNT are as follows:
 - a. Question 1. Was the trust established with the assets of an individual under the age of 65? If no, the trust does not

⁶⁰See Drafting Issues in Self-Settled Special Needs Trusts, Begley and Hook, Estate Planning Journal, (October 2004).

⁶¹*Washington State v. Keffeler*, 537 U.S. 371 (2003).

⁶²POMS SI 01120.203. The Social Security POMS can be found at www.ssa.gov.

qualify. If yes, go to the next question.⁶³

- b. Question 2. Was the trust established with the assets of an individual with disabilities? If no, the trust does not qualify. If yes, go to the next question.
- c. Question 3. Is the individual with disabilities the beneficiary of the trust? If no, the trust does not qualify. If yes, go to the next question.
- d. Question 4. Did a parent, grandparent, legal guardian or a court establish the trust? If no, the trust does not qualify. If yes, go to the next question.
- e. Question 5. Does the trust provide specific language to reimburse the state for medical assistance paid upon the individual's death?⁶⁴ If no, the trust does not qualify. If yes, go to the next question.
- f. Question 6. Does the trust meet the special needs trust exception to the extent that the assets of the individual were put in the trust prior to the individual attaining the age of 65? Any assets placed in the trust after the individual attained the age of 65 are not subject to this exception.
- g. Question 7. Is the trust irrevocable? If no, the trust does not qualify.

4. Additional SSI requirements

⁶³If the trust was established for the benefit of a individual with disabilities prior to the individual attaining the age of 65, the exception to counting the trust as a resource continues to apply after the individual reaches age 65. However, any additions to the trust after the individual reaches the age of 65 are not subject to the transfer exception. The additions would be considered income in the month added and as countable resources in following months. For the purpose of this rule, additions to the trust do not include interest, dividends or other earnings of the trust. See POMS SI 01120.203 B.1.b.

⁶⁴Is the state considered a creditor of the trust or a residuary beneficiary? Generally, the state is considered a creditor. See POMS SI 01120.200 H 1. b. and *Carden v. Astrue*, 2008 WL 867942 (S.D. W.Va.). However, there are exceptions to this general rule, see POMS SI NY01120.200, POMS SI DAL01120.200.

- a. Disability Determination. There is no requirement that the individual be determined disabled by the SSA prior to the creation of the trust. The determination may be made at the time the trust is submitted to the SSA for approval.⁶⁵
- b. Administrative Expenses.⁶⁶
 - (1) Fees and administrative expenses may be paid during the life of the beneficiary as permitted by the trust document.
 - (2) The following expenses may be paid at the individual's death before reimbursement of medical assistance to the state:
 - (a) Taxes due from the trust to the state or federal government because of the death of the beneficiary.
 - (b) Reasonable administrative expenses such as an accounting of the trust to the court, completion and filing of documents, or other required actions associated with termination of the trust.
 - (3) The following expenses and payments are generally not permitted to be paid prior to the reimbursement of the state for medical assistance:
 - (a) Payment of debts due third parties.
 - (b) Funeral expenses (other than irrevocable pre-paid funeral expenses).
 - (c) Payments to residual beneficiaries.
- c. Irrevocability
 - (1) The most common reason for the SSA to declare a

⁶⁵POMS SI 01150.121.

⁶⁶POMS SI 01120.203 B.3.

d(4)(A) SNT to be invalid is the failure to comply with state trust laws regarding irrevocability.

- (2) Not all states have abolished the Doctrine of Worthier Title ("DWT")⁶⁷ that invalidates a self-settled trust for the life of the settlor where the trust residue/remainder is payable to the settlor's "heirs at law" or to the settlor's estate.⁶⁸ For Florida, Georgia, and South Carolina, the trust must specifically name a particular person or entity as the residuary beneficiary.⁶⁹ This is a concern where the individual is mentally incapacitated and his heirs would be the logical residuary beneficiaries(s).
 - (a) In these states the draftsman may designate "my children," "my issue," or "my descendants" as the residuary beneficiaries.
 - (b) The draftsman may not designate my "estate" or "heirs" as the residuary beneficiaries.

⁶⁷Under the common law DWT, an intervivos conveyance by a grantor with a limitation over to his or her heirs at law results in an automatic reversion (and merger of the trust's life and remainder interests into a single unified beneficial interest) in the grantor and therefore nullifies the attempted devise of the residue to the grantor's heirs at law. For example, A conveys property in trust to "A for life and on A's death to my heirs at law." In this case, A, the grantor, is the beneficiary with disabilities and is the sole beneficiary of the SNT. Therefore, as a general rule, a grantor who is the sole beneficiary automatically retains the right to revoke the trust regardless of the statement that the trust is irrevocable. Some states have abolished the DWT, by statute. Where it has not been abolished by statute, the courts have applied the DWT as a rule of construction of the grantor's intent rather than as a rule of law absolutely limiting the power of the grantors. See *Doctor et. al v. Hughes et. al*, 225 N.Y. 305 (1919) and *Bottimore v. The First and Merchants National Bank of Richmond, et al*, 170 Va. 221, 196 S.E. 593 (1938). The Rule in Shelley's case is a distinctly different but analogous rule concerning the heirs at law of someone other than the settlor. See also "When Is an Irrevocable Special Needs Trust Considered to Be Revocable?", by Hook and Begley, *Estate Planning Journal*, (April 2004).

⁶⁸The Atlanta (SI ATL01120.201), Boston (SI BOS01120.200), Chicago (SI CHI01120.201), Dallas (SI DAL01120.200) and New York (SI NY01220.200) Regional offices of the SSA have published regional instructions concerning the revocability of SNTs.

⁶⁹POMS SI ATL01120.201

- (3) For North Carolina, a specific person or entity may be designated. In addition, wording such as “to my estate” or “to the heirs” is sufficient.⁷⁰
- (4) North Carolina has abolished the Rule in Shelley’s Case⁷¹ and the DWT.⁷²
- (5) Virginia has repealed the Rule in Shelley’s Case⁷³ and the DWT.⁷⁴
- (6) West Virginia has abolished the Doctrine of Worthier Title.⁷⁵
 - (a) However a federal district court has held that a d(4)(A) SNT created under West Virginia law that designates the beneficiary’s heirs at law as the remainder beneficiaries is revocable and, therefore, a countable residuary resource for SSI eligibility purposes.⁷⁶
 - (b) The court reached this conclusion despite the fact the trust agreement clearly stated that the trust was irrevocable.
 - (c) This decision is very troubling because it appears to strip away the protection of state statutes that abolish the Doctrine of Worthier Title. Therefore, when drafting a d(4)(A) SNT, the draftsman should consider

⁷⁰POMS SI ATL01120.201., N.C. Gen. Stat. § 41-6.

⁷¹ N.C. Gen. Stat. § 41-6.3.

⁷²N.C. Gen. Stat. § 41-6.2.

⁷³Va. Code Ann. § 55-14 (2008).

⁷⁴Va. Code Ann. § 55-14.1 (2008).

⁷⁵W. Va. Code §36-1-14a (2008).

⁷⁶*Thompson v. Barnhart*, (D. Vt., No. 2-02-CV-141, July 17, 2003). See also *Carden v. Astrue*, 2008 WL 867942 (S.D.W.Va.).

designating specifically named residuary beneficiaries.

- (7) In light of the difference in state laws, the draftsman should carefully specify the state law that will govern the validity and construction of the trust. The draftsman should not provide for an automatic change in governing law if the trustee or beneficiary moves to another state.
 - (8) What should a careful draftsman do to avoid the imposition of the DWT? The draftsman should designate named vested remainder beneficiaries for the SNT. Oast & Hook frequently drafts SNTs that expressly designates, by name, the persons who would be the beneficiary's heirs as the vested remainder beneficiary. If the DWT is a rule of construction (rather than a rule of law) in the applicable state, the trust agreement could expressly provide that it is the grantor's intent to create a remainder interest in his or her heirs and that the DWT is not applicable to the trust.
- d. Legal authority to act with respect to the assets of the individual.
- (1) The SSI POMS provide that "An attempt to establish a trust account by a third party without the legal right or authority to act with respect to the assets of the individual may result in an invalid trust. Note: This requirement refers to the individual who physically took action to establish the trust even though the trust was established with the assets of the SSI claimant."⁷⁷
 - (2) The federal statutes state that a parent or grandparent may create a d(4)(A) SNT for an individual with disabilities. Additionally, the individual with disabilities may not establish his or her trust. How do you create and fund the trust for a disabled but competent adult individual?

⁷⁷POMS SI 01120.203 B.1.f.

- (3) The SSA is currently reviewing the authority to transfer the disabled individual's assets to the d(4)(A) SNT's on a case by case, state by state basis. The Special Needs Alliance held a teleconference with Ken Brown from the SSA SSI division with respect to these issues.
- (a) Mr. Brown said that the new POMS for the establishment of d(4)(A) SNTs are under review.
 - (b) Generally, a court of competent jurisdiction should have the authority to "establish"⁷⁸ and fund a d(4)(A) SNT. Mere court "approval" of the SNT (where the person establishing the SNT does not have authority under the federal statute in the first instance (such as the disabled person's aunt or uncle acting in their capacity as the aunt or uncle)) is not good enough, according to Mr. Brown.
 - (c) Generally, a parent should have the authority to create and fund a d(4)(A) SNT for a minor child.
 - (d) Generally, a parent will not have the authority to transfer an adult child's assets to a d(4)(A) SNT. The SSA, however, has approved a d(4)(A) SNT created by a parent with an initial funding of \$10 of the parent's money for an adult child ("Seed Trust"). Thereafter, the disabled but mentally competent adult child transferred her funds to the trust. Mr. Brown affirmed that a disabled, but mentally competent person may be the beneficiary of an SNT. He also affirmed the use of the \$10 "Seed Trust" by parents of adult beneficiaries with disabilities.

⁷⁸The SSA POMS requires that the court establish and not create the trust. See POMS SI 01120.203 B. 1. a. The SSA POMS do not define what is meant by "establish" a trust. Therefore, it is wise for the courts' order to specifically state that it is establishing the trust as well as any other acts necessary to create a valid trust under applicable state law.

- (e) Generally, a grandparent has no authority to transfer the assets of a grandchild to a d(4)(A) SNT.
- (f) Generally, a guardian/conservator with specific authority from the appointing court should have authority to create and fund a d(4)(A) SNT.

B. State Requirements and Decoupling.

1. There has been an increasing trend among the states to limit the uses, flexibility and availability of SNT's. States will frequently impose additional requirements for d(4)(A) SNT's to qualify as an exempt resource for Medicaid eligibility.
 - a. SSI POMS 01730.048 states "Existence of a Medicaid trust will result in a referral of the case to the Medicaid State agency for a Medicaid eligibility decision. Explain to the individual that the Medicaid State agency will determine Medicaid eligibility."
 - b. North Carolina requires the payback provision to include payback upon death or dissolution of the trust.⁷⁹ North Carolina also requires that proceeds from a settlement on behalf of a Medicaid recipient are used to purchase structured settlement payments, annuities, or other forms of an income stream payable to the Trust over time, the Trust must remain the designated payee. There must be no alternate designated payee named in the contract for the payments until the Trust has been properly wound up and the State has been reimbursed.⁸⁰
 - c. One attorney with the North Carolina Division of Medical Assistance's (DMA's) office found that a trustee having the power to purchase a Life Estate under a d(4)(A) SNT violated the requirement that the trust be for the sole benefit of the disabled beneficiary, and therefore disqualified the trust. The

⁷⁹North Carolina MA-2230 XI.C.3.e.

⁸⁰North Carolina MA-2230 XI.C.3.f.

DMA has also asserted that a trust which allows for the purchase of a fractional interest in a home does not meet the sole benefit requirement and disqualifies the trust.

- d. Arizona has adopted a specific statute imposing reporting requirements on trustees and limiting the types of expenditures from d(4)(A) SNTs.⁸¹
- e. New Mexico has ruled that a d(4)(A) SNT may not hold real estate or disburse funds to provide shelter. New Mexico also prohibits any payments to a person with an obligation to support the trust's beneficiary, thereby eliminating the ability of an SNT to pay the parents of a beneficiary for caretaking.⁸²
- f. Mississippi has established limitations similar to New Mexico's.
- g. New Jersey requires that a d(4)(A) SNT contain the following sixteen provisions: (1) identify the trust as a special needs trust established pursuant to 42 USC §1396p(d)(4)(A); (2) shall not contain any provisions intended to give anyone or court the power to alter the form of the trust to a pooled trust; (3) specifically state that the trust is for the sole benefit of the trust beneficiary; (4) specifically state that its purpose is to permit the use of trust assets to supplement and not to supplant any benefits to which the beneficiary may otherwise be eligible; (5) specifically identify, in an attached schedule, the source of the initial trust property; (6) contain a spendthrift provision; (7) specifically state that the trust is established by a parent, grandparent, legal guardian, or court; (8) state that the trust is irrevocable; (9) specifically identify the trustee by name and address; (10) require the state be given notice of changes in trustee; (11) specifically require that trustee comply with all state laws, including the Prudent Investor Act; (12) state that the trustee will be compensated only as provided by law; (13) specifically require the trustee to notify the state of the death of the beneficiary; (14) state that a formal or informal accounting shall be submitted to the

⁸¹ Ariz. Rev. Stat. § 36-2934-01 (2008).

⁸²See *Hobbs v. Zenderman et al*, 06-CIV-0985 BB/WDS, Filed 3/31/2008, US District Court for District of New Mexico. The decision is currently on appeal to the Tenth Circuit.

state on an annual basis; (15) require the trustee give advance notice of any expenditure in excess of \$5,000; and (16) require the residuary trust estate pass by intestacy.⁸³

- h. Minnesota requires that “...A supplemental needs trust may allow or require distributions only in ways and for purposes that supplement or complement the benefits available under medical assistance, Minnesota supplemental aid, and other publicly funded benefit programs for persons with disabilities. A supplemental needs trust must contain provisions that prohibit disbursements that would have the effect of replacing, reducing, or substituting for publicly funded benefits otherwise available to the beneficiary or rendering the beneficiary ineligible for publicly funded benefits.”⁸⁴
 - i. Illinois⁸⁵ and Colorado⁸⁶ have also passed statutes that are specifically intended to provide protection for funds for persons with disabilities through the use of a trust and impose requirements on such trusts.
- 2. Do the states have the authority to monitor the administration of self settled SNTs? The United States District Court for the District of New Mexico recently answered in the affirmative. It held that “Congress intended to allow states to monitor special needs trusts to ensure they continue to be administered for the sole benefit of the disabled beneficiary.”⁸⁷
 - 3. Attorneys should draft the trust to comply with the requirements of the state in which the beneficiary resides. The draftsman should include a trust amendment provision in the trust agreement to permit the trustee to amend the trust to conform to changes in the law or to comply with the rules of another state if the beneficiary changes the state of his or her residence.

⁸³N.J. Admin. Code 10:71 - 4.11 (2008).

⁸⁴Minn. Stat. §501B.89 Sub. 2(d) (2008).

⁸⁵760 Ill. Comp. Stat. 5/15.1 (2008).

⁸⁶Colo. Rev. Stat. Ann. §15-14-409.8 (2008).

⁸⁷See *Hobbs v. Zenderman et al*, 06-CIV-0985 BB/WDS, Filed 3/31/2008, US District Court for District of New Mexico.

C. Medicaid Manual Requirements.

1. The Virginia Medicaid Manual states that if the beneficiary has legal authority to revoke the trust and then use the funds to meet his or her food or shelter needs, or if the beneficiary can direct the use of the trust principal for his or her support and maintenance under the terms of the trust, then the trust principal is a resource for Medicaid purposes.⁸⁸ Conversely, if the beneficiary does not have the legal authority to revoke the trust or direct the use of the trust assets for his or her own support and maintenance, the trust principal is not the beneficiary's resource.⁸⁹ Therefore it is important that the trust specifically state that the beneficiary does not have the authority to revoke the trust, or to direct the Trustee to make distributions from the trust for any purpose, including to pay for the beneficiary's food or shelter needs.
2. For trusts created before April 1, 1994, the North Carolina Medicaid Manual looks at the discretion given to the trustee in the terms of the trust. If the terms grant the trustee discretion, then North Carolina Medicaid assumes that the trustee will exercise full discretion and counts the full amount that could be disbursed as a countable resource.⁹⁰ If the terms of the trust limit discretion to disburse when Medicaid eligibility will be affected then North Carolina Medicaid only counts those resources which can be disbursed according to the terms of the trust.
3. For trusts created after April 1, 1994 the North Carolina Medicaid Manual instructs that the maximum portion of the trust principal and undistributed proceeds that could be disbursed to the recipient are countable resources. Any principal that cannot be disbursed is considered a transfer of assets.⁹¹
4. The Social Security Administration's policy in the Atlanta Region, which includes North Carolina, follows the principal that if the grantor is the sole beneficiary of a trust, then the trust is revocable

⁸⁸Virginia Medicaid Manual §1120.200(D)(1).

⁸⁹Virginia Medicaid Manual § 1120.200(D)(2).

⁹⁰North Carolina MA-2230 XI.J.2.a.

⁹¹North Carolina MA-2230 XI.J.3.a.&b.

regardless of language to the contrary.⁹²

D. Trustee

1. The appointment of a competent trustee is critical. Frequently the family will consider the money in the trust to belong to the family rather than the beneficiary with disabilities. In other cases, the family is not experienced with investments and public benefits. Therefore, the appointment of a family member as trustee of a d(4)(A)SNT may result in a conflict of interest or mistakes.
2. It is advisable to have an experienced and independent professional or corporation serve as trustee or co-trustee. The drafting attorney should, to the extent appropriate, ensure that a professional or corporate trustee is well qualified to keep up with the public benefits rules, amend the trust if necessary to comply with those rules, disburse funds appropriately, and follow state and federal reporting requirements.

E. Prohibition of contributions after age 65. If assets are added to the d(4)(A) trust after the beneficiary with disabilities reaches the age of 65, the amount added will be treated as a countable resource for SSI eligibility purposes. Therefore, consider drafting the trust to expressly authorize the trustee to refuse to accept additional contributions to a d(4)(A) SNT after the beneficiary attains age 65.

F. Trust Protector. On occasion the serving trustee may not adequately discharge his or her fiduciary duties. Therefore, the trust agreement should designate a trust protector with the authority to remove and replace the trustee.

G. Distribution Provisions. There are several available options.⁹³

1. To avoid having the trust treated as a resource, the trust should not direct distributions to be made for the support, health or maintenance of the beneficiary.
2. A fully discretionary trust may or may not be an available resource depending on state law.

⁹²POMS SI 01120.201 ATL.

⁹³See "Distribution Standard for the Special and Supplemental Needs Trust" by Cynthia L. Barrett, *NAELA Quarterly*, Volume 14, Number 3, Summer 2001.

- a. For example, in Ohio a fully discretionary trust, with no mention of supplemental needs is a resource.⁹⁴
 - b. In Minnesota, a supplemental needs trust must contain provisions that prohibit disbursements that would have the effect of replacing, reducing, or substituting for publicly funded benefits otherwise available to the beneficiary or rendering the beneficiary ineligible for publicly funded benefits.⁹⁵
 - c. North Carolina allows for discretionary trusts where the trustee is guided by, but not restricted by the beneficiary's special needs. It is of utmost importance, however that the intent and purpose of the trust be clearly set forth in the trust.⁹⁶
3. Likewise, a discretionary support trust is unreliable.⁹⁷
 4. Many practitioners use a fully discretionary trust with precatory special needs language.
 5. Some practitioners use a fully discretionary trust but prohibit distributions for food and shelter. In light of the uncertainty of the future needs of the beneficiary, this standard is overly restrictive in most states.
 6. Some practitioners use a fully discretionary trust that specifically authorizes the trustee to provide in kind support if the trustee deems the beneficiary's needs will be better met with the distribution in spite of the partial reduction in SSI benefits because of the PMV rule.

⁹⁴Ohio Rev. Code Ann.5815.28. Ohio additionally limits the size of the principal of SNTs and requires that at the death of the beneficiary one half of the trust principal be deposited into a state fund for the benefit of individuals with mental retardation and developmental disabilities.

⁹⁵Minn. Stat. 501B.89, 2(d)

⁹⁶See *Lineback by Hutchens v. Stout* where the North Carolina Court of Appeals takes note that the testator referred to the sole judgment or discretion of the trustee no less than six times. 339 S.E.2d 103, 79 N.C. app. 292 (1986).

⁹⁷See *Third Party and Self-Created Trusts* by Clifton B. Kruse, Jr, published by the American Bar Association.

- H. Bonding and Surety. The d(4)(A)SNT should expressly address the issue of whether the trustee will be required to post a bond with surety.
- I. Qualification and Public Accountings. If the d(4)(A)SNT is created by a court or guardian, the order establishing the trust and the trust agreement should specifically state whether the trustee is required to qualify as trustee before a court and/or file public accountings with the court.
- J. Powers of Trustee. The d(4)(A)SNT should expressly enumerate the trustee's powers. Trusts that are to be administered in Virginia should, at a minimum, contain references to Code of Virginia §§ 64.1-57 and 55-548.16. North Carolina Powers of a Trustee are found in N.C. Gen. Stat. § 36C-8-815 and N.C. Gen. Stat. § 36C-8-816.
- K. Spendthrift Provision. The d(4)(A)SNT should contain a provision protecting the trust assets from the claims of the beneficiary's creditors and prohibit assignment by the beneficiary. However, because the d(4)(A) SNT was funded with the assets of the beneficiary with disabilities, it is a matter of state law whether the spendthrift provision will be effective against the beneficiary's creditors.⁹⁸
- L. Fees, Taxes and Administration. The d(4)(A)SNT should contain express authority for the trustee to pay reasonable legal fees, care management fees, taxes, and administrative expenses from the trust.
- M. Trustee Compensation. The d(4)(A)SNT should authorize the trustee to pay himself or herself reasonable compensation in accordance with a state statute or in accordance with express provisions in the trust.
- N. Amendment. The d(4)(A)SNT should authorize the trustee or the court having jurisdiction over the trust to amend the trust as necessary to comply with applicable federal and state laws, regulations and policy concerning d(4)(A) SNTs.

⁹⁸. North Carolina spendthrift provisions should meet the requirements found in N.C. Gen. Stat. § 36C-5-502. A d(4)(A) SNT is funded with the disabled beneficiary's assets. Generally, whether a trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settler-beneficiary. If the trustee has discretion to distribute the entire income and principal to the settler, the creditors may reach all of the trust assets. See §502(a)(2) of the Uniform Trust Code and the Restatement (Third) of Trusts §58(2). Several states, including Alaska, Delaware, Rhode Island, and Nevada, have revised this rule to permit self-settled asset protection trusts. If greater asset protection is desired, the d(4)(A) SNT should be drafted and administered in accordance with the asset protection trust laws of one of those states

- O. Grantor Trust Status. In light of the compressed tax rates for trusts and the beneficiary's normally low marginal income tax rate, consider drafting the d(4)(A)SNT as an intentionally defective grantor trust.⁹⁹

VI. DRAFTING A d(4)(C) SNTs

A. POMS Requirements

1. The SSA POMS provides that the provisions of the SSI trust statute do not apply to a d(4)(C) SNT containing the assets of a disabled individual that meets the following conditions:¹⁰⁰
 - a. The d(4)(C) SNT is established and maintained by a nonprofit association;
 - b. Separate accounts are maintained for each beneficiary, but assets are pooled for investing and management purposes;
 - c. Accounts are established solely for the benefit of the disabled individual;
 - d. The account in the trust is established by the individual, a parent, grandparent, legal guardian, or a court; and
 - e. The d(4)(C) SNT provides that to the extent any amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust will pay to the State the amount remaining up to an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under a State Medicaid plan.
2. If a d(4)(C) SNT that meets the preceding requirements is revocable, the exception to the SSI statutory trust provisions in section 1613(e) of the Social Security Act applies, but the trust must still be evaluated under the instructions in SI 01120.200 to determine if it is a countable resource. If the revocable trust meets the definition of a resource (SI 01110.100B.1.), it would be subject to regular resource-counting rules.

⁹⁹See, Section VII (I)(1)(c)(1) below.

¹⁰⁰POMS SSI01120.203 B. 2.

3. A third party establishing the d(4)(C) SNT trust account on behalf of the individual must have legal authority to act with regard to the assets of the individual. An attempt to establish a trust account by a third party without the legal right or authority to act with respect to the assets of the individual may result in an invalid trust.
4. Can you establish and fund a d(4)(C) SNT after the beneficiary reaches age 65? Many states say yes and others say no. Region One of the Centers for Medicare & Medicaid Services (CMS) has taken the position that a d(4)(C) SNT established by an individual age 65 and older is not exempt from the transfer of asset penalty provisions.¹⁰¹

B. Drafting the d(4)(C) SNT

1. A few attorneys have formed nonprofit organizations and drafted a d(4)(C) SNT for the organization. Others have drafted them on behalf of an established nonprofit organization. Most attorneys will assist a person with a disability in establishing a d(4)(C) SNT by explaining the trust, the attendant costs and benefits of the trust to the client; helping the client choose the d(4)(C) SNT to use; preparing the joinder agreement; assisting with the transfer of funds to the trustee; and reporting the creation of the trust to the SSA and state Medicaid agency.
2. The d(4)(C) SNT is formed by the nonprofit organization adopting a master trust agreement. Thereafter accounts for persons with a disability will be established by execution of a joinder agreement by the individual, a parent, grandparent, legal guardian, or a court.¹⁰²

VII. DRAFTING PROVISIONS FOR THIRD PARTY SNTs

A. POMS Requirements

¹⁰¹State Agency Regional Bulletin No. 2008-05 from Richard R. MCGreal, Associate Regional Administrator, Region I, CMS. The Commonwealth of Virginia recently changed its position concerning post age 65 transfers to d(4)(C) Trusts. Effective July 1, 2008, for all actions involving the determination of Medicaid eligibility for long-term care services, a d(4)(C) trust is not exempt for the transfer of asset penalties. See Broadcast 5011 dated 6/25/2008 to Local Directors and Medicaid Assistance Eligibility staff from Stephanie Sivert, Manager, Medical Assistance Programs.

¹⁰²See Form ¶16.06 of *Representing the Elderly or Disabled Client*, by Begley and Hook, published by RIA, for examples of d(4)(C) SNT master trust agreement and joinder agreements.

1. The SSA POMS provides that if an individual (claimant, recipient, or deemor) has legal authority to revoke the third party SNT and then use the funds to meet his food or shelter needs, or if the individual can direct the use of the trust principal for his/her support and maintenance under the terms of the trust, the trust principal is a resource for SSI purposes.¹⁰³
2. Additionally, if the third party SNT provides for mandatory disbursements to the beneficiary and the beneficiary is not prohibited from anticipating, assigning or selling the right to future payments, the current value of these payments may be a resource to the beneficiary. For example, if the trust provides for payment of \$100 per month to the beneficiary for spending money, absent a prohibition to the contrary, the beneficiary may be able to sell the right to future payments for a lump-sum settlement.¹⁰⁴
3. The POMS further states that if an individual does not have the legal authority to revoke the third party SNT or direct the use of the trust assets for his/her own support and maintenance, the trust principal is not the individual's resource for SSI purposes. The revocability of a trust and the ability to direct the use of the trust principal depends on the terms of the trust agreement and/or on State law. If a trust is irrevocable by its terms and under State law and cannot be used by an individual for support and maintenance, it is not a resource.¹⁰⁵ Therefore it is important that the trust specifically state that the beneficiary does not have the authority to revoke the trust, or to direct the Trustee to make distributions from the trust for any purpose, including to pay for the beneficiary's food or shelter needs.

B. Medicaid Requirements

1. The Virginia Medicaid Manual states that if the beneficiary has legal authority to revoke the third party SNT and then use the funds to meet his or her food or shelter needs, or if the beneficiary can direct the use of the trust principal for his or her support and maintenance under the terms of the trust, then the trust principal is a resource for Medicaid

¹⁰³POMS SI 01120.200 D 1. a.

¹⁰⁴POMS SI 01120.200(D)(1)(a).

¹⁰⁵POMS SI 01120.200(D)(2).

purposes.¹⁰⁶

2. Conversely, if the beneficiary does not have the legal authority to revoke the third party SNT or direct the use of the trust assets for his or her own support and maintenance, the trust principal is not the beneficiary's resource.¹⁰⁷ Therefore it is important that the trust specifically state that the beneficiary does not have the authority to revoke the third party SNT, and that the trust does not direct the Trustee to make distributions from the trust for any purpose, including to pay for the beneficiary's food or shelter needs.
3. The North Carolina Medicaid Manual looks at the discretion given to the trustee in the terms of the trust. If the terms do not allow for trustee discretion, then any portion of the trust principal and undistributed proceeds that could be disbursed are counted. If the terms grant the trustee discretion, then the amount that the Trustee agrees to make available is counted. If the trustee refuses to make any portion available, then nothing is counted.¹⁰⁸

C. Purpose Clause

1. Sets out Parents' (grantors) desire that the third party SNT assets have been set aside to provide for special, supplemental, or emergency needs. This distinguishes the purpose of the trust from the standard "support, maintenance and health" trusts.
2. Grantors should avoid language that evidences a desire to meet "support, maintenance and health" needs, because this leaves open a judicial interpretation requiring the third party SNT to pay for those services that otherwise would be provided by public programs.

D. Non-reduction clause. This cause establishes that the Trustee is to use the trust estate to promote the happiness, welfare and development of the beneficiary without in any way reducing the services or financial assistance in basis maintenance, support, residential, medical or dental care that the beneficiary may receive in his or her own right from any local, state, or federal government agency or department thereof, and without using any portion of the trust estate, income or principal, to reimburse any local, state

¹⁰⁶Virginia Medicaid Manual §1120.200(D)(1).

¹⁰⁷Virginia Medicaid Manual § 1120.200(D)(2).

¹⁰⁸North Carolina MA-2230 XI.J.1.a.and b.

or federal government or agency or department thereof, or private agency or department thereof for basic maintenance, support, medical and dental care received by the beneficiary, in his or her own right.

E. Emergency clause

1. This clause permits the Trustee to contravene the “non-reduction” principal that trust assets should not be used if they would cause loss of public benefits. The Trustee is given discretion to determine the existence of an “emergency,” which loosely defined would arise when available public resources were so inadequate that the primary needs of the beneficiary could not be met without the intervention of the Trustee.
2. For example, the beneficiary receives \$564 in SSI benefits, but receives no housing subsidy and must secure housing at fair market rental. To meet emergency housing needs, the Trustee chooses to secure an apartment for the beneficiary and allow him to live there rent-free, causing a one-third reduction in the beneficiary's SSI benefits.

F. Authority to rent property to the beneficiary. This clause permits the trustee to charge rent (or not) to the beneficiary for property owned or leased by the trust (e.g. a condo). This clause may allow the beneficiary to qualify for rental subsidies or avoid reduction in SSI benefits.

G. Spendthrift Clause. This clause eliminates the ability of the beneficiary to encumber or alienate the trust estate, and protects the trust estate from claims of the beneficiary’s creditors.

H. Discretion. This clause permits the trustee to use its discretion with respect to the use of income and or principal to meet the beneficiary’s special needs. So long as the Trustee has the complete discretion to determine if, when and how the disbursement from the third party SNT will be made, the assets in trust will not be counted as a resource of the beneficiary and will allow the beneficiary to remain eligible for programs such as SSI and Medicaid, which are “resource” sensitive.

I. Termination Clause

1. This clause permits the Trustee to terminate the third party SNT in favor of other family members if and when the trust estate becomes liable for services that otherwise would be provided through public programs.

2. This clause is only exercised if the Trustee determines the third party SNT would no longer provide benefits to the beneficiary and the funds would be wasted. For example, the beneficiary is hospitalized in a state facility at no cost, but changes in state laws would require that the trust pay for “cost of care.” Given the high cost of state care, the Trustee determines that trust principal would be expended within two years, with no expectation that the beneficiary would be able to leave the facility or benefit from the trust. The Trustee concludes that the trust purposes are no longer viable and terminates the trust in favor of the remaindermen.
- J. Amendment Clause. This clause permits the Trustee to amend the third party SNT to ensure that the trust will not disqualify the beneficiary for public benefits. This clause can be very helpful to protect the trust estate if there are changes in the applicable laws or regulations.¹⁰⁹
- K. Trustee
1. The appointment of a competent trustee is critical. Frequently the family will consider the money in the trust to belong to the family rather than the disabled beneficiary. In other cases, the family is not experienced with investments and public benefits. Therefore, the appointment of a family member as trustee of the third party SNT may result in a conflict of interest or mistakes.
 2. It is advisable to have an experienced and independent professional or corporation serve as trustee or co-trustee. The drafting attorney should ensure that a professional or corporate trustee is well qualified to keep up with the public benefits rules, amend the trust if necessary to comply with those rules, disburse funds appropriately, and follow state and federal reporting requirements.
- L. Trust Protector. The trust agreement should designate a trust protector with the authority to remove and replace the trustee. This can be helpful in the situation in which the serving trustee may not adequately discharge his or her fiduciary duties. If the trustee is a corporate or professional trustee, the trust

¹⁰⁹The Ohio Supreme Court has held that “... when a trust beneficiary makes an application for participation in Medicaid, the Medicaid-eligibility-review rules in effect at the time of the application is filed govern the applicant’s eligibility.” *Pack v. Osborn*, 117 Ohio St.3d 14, 2008-Ohio-90. This decision reversed the Ohio Court of Appeals which had held that the state must apply the law in effect at the the trust agreement was created. Court of Appeals for Licking County, No. 05-CA-83, 2006-Ohio-2253.

protector can be a family member (but cannot be the beneficiary or the beneficiary's spouse). This can give the family some oversight with respect to the trust administration.

M. Distribution Provisions

1. There are several available options.¹¹⁰ First, to avoid having the trust treated as a resource, the trust should not direct distributions be made for the support, health or maintenance of the beneficiary.¹¹¹ Likewise, a discretionary support trust is unreliable. The discretionary support trust is drafted to give the trustee discretion as to whether or not to make distributions for the beneficiary's support. The courts interpret such trusts based on the intention of the trusts' grantor.¹¹²
2. Many practitioners use a fully discretionary trust with precatory special needs language.¹¹³
3. Some practitioners use a fully discretionary trust but prohibit distributions for food and shelter. In light of the uncertainty of the future needs of the beneficiary, this standard is probably over restrictive in most states.
4. Some practitioners use a fully discretionary trust that specifically authorizes the trustee to provide in-kind support, if the trustee deems the beneficiary's needs will be better met with the distribution in spite of the partial reduction in SSI benefits because of the PMV rule.

N. Powers of Trustee. The trust should expressly enumerate the trustee's powers.

O. Fees, Taxes and Administration. The third party SNT should contain express authority for the trustee to pay reasonable legal fees, care management fees, taxes, and administrative expenses from the trust.

¹¹⁰See "Distribution Standard for the Special and Supplemental Needs Trust" by Cynthia L. Barrent, *NAELA Quarterly*, Volume 14, Number 3, Summer 2001.

¹¹¹Section 4.02[B] of the *Special Needs Trust Handbook*, Begley and Canellos, published by Aspen Publishers.

¹¹²Section 4.02[D] of the *Special Needs Trust Handbook*, Begley and Canellos, published by Aspen Publishers.

¹¹³Section 4.02[F] of the *Special Needs Trust Handbook*, Begley and Canellos, published by Aspen Publishers. However, state law must be consulted.

- P. Trustee Compensation. The third party SNT should authorize the trustee to pay himself or herself reasonable compensation in accordance with a state statute or in accordance with express provisions in the trust.
- Q. Planning for Retirement Plan Distributions.¹¹⁴
1. Retirement plan (401(k), 403(b), IRA, Simple IRA, SEP etc.) accounts are frequently a significant portion of the savings of parents with children having special needs. The parents will frequently wish to designate the third party SNT as the beneficiary of these accounts after both of them are deceased and preserve the right of the trust to take Minimum Required Distributions (MRD).
 2. A Conduit Trust¹¹⁵ is not suitable for beneficiaries who are qualified for SSI, Medicaid, or other means tested public benefits. The distributions from the trust will be income for eligibility determination.
 3. If the third party SNT will be the beneficiary of retirement plan benefits, it should be drafted as an Accumulation Trust.¹¹⁶ The Accumulation Trust permits the Trustee to accumulate MRDs in the trust principal and make distributions for the benefit of the disabled beneficiary in the trustee's discretion.
- R. Caution
1. Many draftspersons insert a provision that “no part of the principal or income of this trust may be distributed for food or shelter, or to replace any public assistance benefits for which the beneficiary may be eligible.” This provision is mistakenly thought to be necessary to maintain SSI eligibility; this is incorrect.

¹¹⁴For a complete discussion of this subject see Chapter 6 of *Life and Death Planning for Retirement Benefits*, 6th Edition, Natalie Choate.

¹¹⁵A “Conduit Trust” is a trust under which the trustee has no power to accumulate retirement plan distributions. The trustee is required by the terms of the trust agreement to distribute to the trust beneficiary any retirement plan distributions.

¹¹⁶To permit MRDs, the Accumulation Trust must be drafted so that the trust principal passes outright at the disabled beneficiary's death to other now-living individuals.

2. An additional provision drafters often include is one requiring the Trustee to seek support and resources for the beneficiary from all public benefits programs. While well-meaning, this provision places liability on the Trustee for a role he or she cannot fulfill unless he or she also serves as a guardian or conservator for the beneficiary.
3. Granting the disabled person a “Crummey” withdrawal right will interfere with the beneficiary’s eligibility for public benefits. During the withdrawal period he or she will have a resource and the lapse of the withdrawal right may result in a transfer penalty for SSI and Medicaid if the grantors wishes to his or her annual gift tax exclusion for gifts to the third party SNT, the following strategies¹¹⁷ should be considered:
 - a. grant noncontingent *Cristofanfi* Crummey Withdrawal rights to the remainder beneficiaries, or
 - b. specially authorize the trust to own a 529 plan for the benefit of the disabled person and have the grantor make gifts directly to the 529 Plan.¹¹⁸

VIII. SNT ADMINISTRATION¹¹⁹

- A. The administration and taxation of both self-settled and third party SNTs are complex, particularly because the laws and regulations governing needs-based benefits often change. Drafting attorneys should notify trustees in writing about the trustees' responsibilities, and when feasible, the drafting attorney should be available to answer questions that trustees may have as the trust administration continues.

¹¹⁷See "Tax-Efficient Gifting to Persons with Disabilities Using Cristofani Trusts and 529 Plans," by Polly Levin and Kevin Urbatsch, *The ElderLaw Report*, May 2008.

¹¹⁸The IRS has issued an advanced notice of proposed rule making concerning trust ownership of 529 plans. You should check to see if (1) new rules have been issued concerning trust ownership of 529 plans and (2) the plan under consideration permits a trust to own the plan. Not all states permit trusts to own 529 Plans.

¹¹⁹The Special Needs Alliance (SNA) has published a brochure entitled “Administering a Special Needs Trust, A Handbook for Trustees” to educate the trustees of SNT’s. Copies can be ordered by contacting the SNA at www.specialneedsalliance.com. See also Special NeedsTrust Administration: Special Assets, Begley and Hook, *Estate Planning Journal* (April 2008).

B. Notification to the Social Security Administration¹²⁰

1. Notification is required in two circumstances:
 - a. SSI recipients, and their representative payees, are under a continuing obligation to report any change in their income, resources, living arrangements or other conditions.
 - b. The client must report the existence of a d(4)(A) or d(4)(C) SNT when he or she is applying for SSI or Medicaid.¹²¹ The beneficiary must also report the creation and funding of a third party SNT when the trust is funded.
2. The failure to notify or report to the SSA can result in huge overpayment claims against the trust if the SSA becomes aware of the trust after the beneficiary has received significant SSI benefits and the SSA rules that the trust is a countable resource. The SSA will frequently become aware of the trust by an IRS computer check against the SSI rolls, which the SSA does constantly. If the trust is immediately reported to the SSA, corrective action can frequently be taken before the SSA has a large over payment claim.
3. The notification can be in the form of a letter to the local SSA office which should include (i) the beneficiary's name and (ii) Social Security number together with a copy of the trust agreement and trust records showing the receipt of funds. The letter should expressly answer all of the questions in an SSI step action chart¹²² with references to the applicable sections of the trust agreement.
4. The beneficiary, or his or her representative payee, has the duty to report.¹²³ However, it is a matter of good practice for the attorney to prepare and file the report. The report should be made by letter mailed to the local Social Security Administration office responsible

¹²⁰20 CFR 416.708 (2008).

¹²¹When you prepare a d(4)(A) or joinder agreement for a d(4)(C) SNT for a child who will not apply for SSI until he or she reaches the age of 18 because of parental "deeming" of income, consider giving to the parents a letter to the SSA notifying the SSA of the trust. The parents should be instructed in writing to attach the letter to the SSI application when it is filed after the child reaches age 18.

¹²²See POMS SI 01120.203 D. 1.

¹²³20 CFR 416.704 (2008).

for providing services to the beneficiary by certified mail return receipt requested.¹²⁴ If filed by the attorney, the attorney should attach a form SSA - 1696, Appointment of Representative and include within his cover letter a request that the SSA direct all correspondence and questions to the attorney.

5. The report is due as soon as the event occurs, but is late if not made by the 10th of the following month.¹²⁵
6. Upon receipt of the notice, the Claims Representative (“CR”) reviews it in accordance with the action chart and approves it if appropriate. If the CR has questions, he or she will submit it to the Regional office for an analysis and report. There may be no response for months, and if the trust is approved there may be no response.
7. Upon receipt of an unfavorable initial determination, the following steps should be taken:
 - a. Determine who will represent the client on appeal:
 - (1) The attorney who has prepared the trust and submitted it to the SSA but has not represented the client before the SSA.
 - (2) Once an appeal is filed, however, a new fee arrangement must be secured.¹²⁶
 - (a) In the absence of prior approval from the SSA, no fees may be charged to the beneficiary or the trustee for legal representation before the SSA.¹²⁷

¹²⁴The local office should be the SSA office for where the client lives, unless the client has a representative payee, then it should be for the local office where the representative payee lives. You can obtain the address of the local SSA office at <http://s00dace.ssa.gov/pro/foi/foi-home.html>.

¹²⁵20 CFR 416.714 (2008)

¹²⁶42 U.S.C. §406(a)(5) (2008).

¹²⁷Practice Note: Because the attorney will not have obtained advance approval for a fee to submit the trust to the SSA for review, the authors recommend that you specifically not charge a fee for that service. Ken Brown from SSA/SSI, however, in a recent teleconference with the Special Needs Alliance, stated that an attorney providing services concerning the establishment

- (b) Failure to obtain advance SSA approval of fees may result in the attorney committing a crime and being barred from practicing before the SSA.
- (3) The attorney representing the beneficiary should file with the SSA a Form 1696, together with a copy of his or her fee agreement. This form may be obtained from the SSA's Office of Hearings and Appeals.
- (4) When the representation is complete, the attorney must submit a Petition for Approval of Fee.
 - (a) The SSA's criteria for evaluating fee petitions include the following:¹²⁸
 - i) the extent and type of services performed.
 - ii) the amount of time spent on the case.
 - iii) the complexity of the case.
 - iv) the level of skill and competence required.
 - v) the results obtained.
 - vi) the level of review to which the case was taken.
 - (b) The fee determination process can take months and the trustee may not pay your fee without fee approval by the SSA.
 - (c) Keeping time records and having a written fee agreement are essential.

or administration of a d(4)(A) SNT does not need SSA approval of his or her fees for that service.

¹²⁸In the cover letter requesting approval of the fee, cite the facts in the case that apply to each of these criteria.

- (d) The SSA assumes no responsibility for payment of the fee for SSI appeals.
- b. Request for Reconsideration
 - (1) Request that the CR fax or mail you the analysis of the trust by the Regional Office.
 - (2) The request for reconsideration is made by filing Form SSA-561-U2.
 - (3) There are three types of review: (i) case review, (ii) informal conference, and (iii) formal conference. Case reviews seldom result in a favorable decision. Always request an informal or formal conference, both of which permit an in person presentation and the calling of witnesses. However, witnesses may be subpoenaed in a formal conference. Conferences may be held in person or by phone. However, it is preferable to hold the conference in person.
 - (4) After the conference, the SSA will issue a written notice of Reconsideration. An unfavorable decision triggers another deadline (10 days to continue benefits and 60 days to continue the appeal).
- c. Administrative Law Judge Hearing
 - (1) The request for a hearing by an Administrative Law Judge is made on form SSA HA-501-U5
 - (2) Hearings are usually scheduled for one hour and are followed by a formal written decision.
 - (3) The ALJ's decision is final unless a review of the decision is requested within 60 days.
- d. Appeals Council Review. The request for the Review of the Hearing Decision is made on form HA-520-U5.
- e. Judicial Review. After exhausting the beneficiary's administrative appeals, the beneficiary may petition for judicial review by filing a Complaint against the Commissioner of the SSA in the United States District Court.

C. Notification to the State

1. Medicaid recipients are under a continuing obligation to report any change in their income, resources, living arrangements or other conditions.
2. The beneficiary, whether in a 209(b), SSI or 1634 state, must report the creation and funding of a (d)(4)(A) or (d)(4)(C) SNT or third party SNT (when funded) to the local Medicaid eligibility office. It is a matter of good practice, however, for the attorney to prepare and file the report.
3. If the beneficiary receives Section 8 housing vouchers, the beneficiary should report the creation and funding of the SNT to the local PHA. Once again, it is good practice for the attorney to prepare and file the report.

D. Trust Administration Duties. The Trustee of a Third Party, d(4)(A) or d(4)(C) SNT must fulfill the normal fiduciary duties of a trustee, including:¹²⁹

1. Take custody of and title the trust assets in the name of the trust.
2. Comply with the terms of the trust agreement and state law.
3. Keep detailed records and provide the beneficiary and/or representative with regular accountings.
4. Invest the trust assets in compliance with the Prudent Investor Act.

E. Written Advice. When drafting a d(4)(A) SNT, the drafts person should provide detailed, written advice concerning the creation, funding, management and distribution (including SSI distribution rules) of the trust to the Trustee and to the plaintiff's counsel where the trust is being funded with litigation proceeds. The drafter should mail the advice to the trustee and personal injury attorney by certified mail, return receipt requested.

F. SSA Policy Concerning Disbursements from a SNT¹³⁰

1. Cash paid directly from the SNT to the SSI beneficiary is unearned income.

¹²⁹See Article 8 of the Uniform Trust Code (UTC)

¹³⁰POMS SI 01120.201.1.

2. Food or shelter received by the beneficiary as a result of disbursements from a SNT to a third party is income in the form of ISM¹³¹ and is valued under the presumed maximum value (PMV) rule, which is the lesser of: (i) the amount distributed by the trust, or (ii) \$232 in 2008 (one-third the federal benefit rate (SSI) plus \$20).¹³² Examples of these disbursements are:
 - a. Food
 - b. Mortgage payments
 - c. Real property taxes
 - d. Rent
 - e. Heating fuel, gas, and electricity
 - f. Water
 - g. Sewer
 - h. Garbage removal
 - i. Homeowner insurance premiums that are required by the mortgage company

3. Disbursements from the SNT by the trustee to a third party that results in the individual receiving items that are not food or shelter are not income. For example, the following trust distributions are not income to the SSI recipient:
 - a. Payments to a spouse or parent for attendant care. The amount paid should be pursuant to a written prior or contemporaneous agreement and based on the going rates for such services by a person with the same training and expertise as the family member.¹³³

¹³¹For a definition of ISM, see paragraph C.1 of Section III above.

¹³²See POMS SI 00835.300 for instructions pertaining to the PMV rule and SI 01120.200F for rules pertaining to a home.

¹³³Bernstein, Roger M., Special Needs Trust: Administration and Compliance, NAELA Quarterly (Summer 2001) Vol. 14 No. 3 at page 13.

- b. Payments for medical and supportive services, supplies and equipment.
- c. Dental work not covered by Medicaid.
- d. Payments for educational and vocational services.
- e. Purchase of appliances (TV, VCR, stereo, microwave, stove, refrigerator, washer, dryer ...)
- f. Purchase of a computer and internet services.
- g. Payment for personal services such as mowing the lawn, doing the housecleaning, grocery shopping, haircuts and babysitting.
- h. Purchase of pets and pet supplies.
- i. Payment of legal or accounting fees.
- j. Payments for recreation and short term vacations.
- k. Purchase of fitness equipment or fitness club membership.
- l. Purchase and maintenance of a car or van and purchase of gasoline and oil for the vehicle.
- m. Payment of insurance premiums (automobile, home and personal property).
- n. Purchase of non-food grocery items (laundry soap, deodorant, paper towels, Kleenex, toilet paper, ...) and over the counter medications.
- o. Payment of telephone and utility (cable TV, electric and heating) expenses.
- p. Payment for care management.
- q. Payment of a beneficiary's credit card bill; however, according to Ken Brown from SSA/SSI, payment of charges on a beneficiary's credit card bill for food or shelter items will result in ISM to the beneficiary. Debit cards should not be used by beneficiaries because they are considered resources.

4. In appropriate cases, the beneficiary should obtain a credit card. Credit cards are loans, and loans are not considered income for SSI or Medicaid purposes. The SNT can make the payments on the credit card. If the credit card is used to purchase food or shelter, these payments are considered ISM and result in a reduction of the SSI benefit. It is difficult to obtain credit cards for disabled individuals. The SNT trustee should consider helping the beneficiary obtain a card with a low credit limit by depositing funds with the firm issuing the card and granting the issuer a security interest in the account to secure payment of the credit card invoices.
5. Gift cards are cash and the trustee of an SNT should not provide them to the beneficiary.

G. Medicaid Requirements

1. According to the Virginia Medicaid Manual, cash paid directly from the SNT to the beneficiary is income to the beneficiary.¹³⁴ Disbursements from the SNT for food and shelter paid to a third party are considered income in the form of in-kind support and maintenance and are not counted for Medicaid purposes,¹³⁵ but are counted for SSI purposes under the PMV rule, discussed in Section VIII, F, 2, immediately above. Disbursements from the SNT to a third party that result in the beneficiary receiving items that are not food or shelter are not income to the beneficiary.¹³⁶
2. North Carolina's Medicaid Manual attributes cash paid directly from the SNT to the beneficiary as income. North Carolina differs from Virginia in that disbursements made for food and shelter by the trustee to a third party is considered income for purposes of Medicaid.¹³⁷

H. State Requirements and Decoupling

1. It is critically important that Trustees are aware of and follow state

¹³⁴Virginia Medicaid Manual §S1120.200(E)(1)(a).

¹³⁵Virginia Medicaid Manual §S1120.200(E)(1)(b).

¹³⁶Virginia Medicaid Manual §S1120.200(E)(1)(c).

¹³⁷North Carolina MA-2230 XI.F.2. and North Carolina MA-2250 VI.B.11.

regulations with respect to disbursements from d(4)(A) trusts. See Section V (B), above, for a discussion of the recent trend of states decoupling Medicaid eligibility requirements from the SSI requirements. Several states have established limitations on disbursements from d(4)(A) trusts, and have also established strict reporting requirements for trustees to ensure compliance with the limitations on disbursements.

2. Although North Carolina does follow SSI's PMV rules with regard to disbursements from d(4)(A) trusts, some states do not. For example, the Virginia Medicaid Manual states: "Food or shelter received as a result of disbursements from the trust by the trustee to a third party are income in the form of in-kind support and maintenance." The Manual does not limit the income value to the PMV.¹³⁸
3. Arizona by statute specifically lists the disbursements that may be made from a d(4)(A) or d(4)(C) SNT.¹³⁹
4. In New York, the Trustee must notify the Department of Social Services (DSS) of the creation/funding of a d(4)(A) or d(4)(C) SNT, notify the DSS of the death of the beneficiary, notify the DSS of intent to substantially deplete the value of the trust, notify the DSS of transfers for less than fair market value, and provide proof of bonding if trust assets exceed \$1 Million.¹⁴⁰
5. The Trustee of a SNT should retain public benefits counsel and hold regular meetings with the counsel to receive input and make decisions concerning distributions and reporting requirements. The Trustee should maintain written minutes of the meeting.

I. Trust Taxation Issues

1. Income Tax

a. Prior to funding a (d)(4)(A) or (d)(4)(C) SNT.

- (1) Frequently, a d(4)(A) or d(4)(C) SNT will be funded with the proceeds of a tort settlement or judgment.

¹³⁸North Carolina MA-2230 XI.F.2. and Virginia Medicaid Manual §S1120.200 (E)(1)(b).

¹³⁹Section 36-2934.01 of the Arizona Revised Statutes.

¹⁴⁰18 NYCRR § 360-4.5(b)(5)(iii)

- (2) For federal income tax purposes, gross income does not include damages because of personal physical injury or illness.¹⁴¹ This rule applies whether the funds are received by settlement or judgment. However, all amounts attributable to lost wages or punitive damages are taxable. Additionally, payments made on account of emotional distress not attributable to a physical injury, which are in excess of the payment of medical care, are includable in gross income.
 - (3) Where there is a structured settlement and the periodic payments include interest, the interest is not includable in the taxable income of the recipient, as long as the defendant purchased the annuity. Additionally, the plaintiff may not own the annuity and may not have the right to accelerate payments. Therefore, to avoid “constructive receipt” by the plaintiff, the defendant should purchase the structured settlement annuity contract and designate the trustee of the d(4)(A) or d(4)(C) SNT as the beneficiary of the annuity payments.
- b. Taxpayer ID Number. The d(4)(A) SNT should have its own taxpayer ID number. The taxpayer ID number is obtained by applying to the IRS on form SS4. The beneficiary’s taxpayer ID number should not be used for the trust. The SSA will match income reported to the IRS with its rolls. Using a separate TIN for the trust helps distinguish between the trust’s and the beneficiary’s income for SSI eligibility purposes. The third party SNT should have its own taxpayer ID number when the trust is funded.
 - c. Fiduciary Income Tax.
 - (1) A d(4)(A) SNT normally should be drafted to be an intentionally defective grantor trust¹⁴² to insure that the trust’s income is taxed at the grantor’s rate (i.e. the disabled beneficiary’s rate) rather than the trust’s rate. For example, the trust agreement should provide that

¹⁴¹IRC §104(a)(2) (2008).

¹⁴²IRC §§671 through 679 (2008).

a third party, preferably someone other than the beneficiary with disabilities, has the power in a nonfiduciary capacity to reacquire the trust corpus by substituting property of equal value.¹⁴³

- (2) For reporting purposes, where a single person is treated as the owner of the trust for income tax purposes, but the trustee is not the grantor, the trustee must choose between two approaches:¹⁴⁴
 - (a) Furnish the name, address and TIN of the trust to all account holders and income payers; issue a form 1099 to the grantor showing the income received by the trust; file a form 1041 without income or deductions but with an attached statement showing the owner/grantor's name, address, Social Security Number and the amounts of income and deductions; or
 - (b) Furnish the name and Social Security number of the grantor to all account holders and income payers, along with the address of the trust; obtain a signed Form W-9 from the grantor/beneficiary.
- (3) A qualified disability trust ("QDT") allows the trust to

¹⁴³IRC §675(4)(c) (2008). See, PLRs 199908002, 9247024 (power to substitute assets held by a third party), and 20011012 (power to substitute assets held by the grantor). See also, the IRS' sample inter-vivos CLUT and CLAT forms in Rev. Proc. 2008-45, 2008-30 I.R.B. 224 (July 24, 2008) and Rev. Proc. 2007-45, 2007-29 I.R.B. 1 (June 22, 2007), respectively, which contain the power of substitution held by a third party (but with the usual IRS disclaimer stating that whether the power to substitute assets held in a non-fiduciary capacity is an issue of fact that the IRS can not determine in advance). Section 11 of the sample inter-vivos CLUT and CLAT forms provides "Retained Powers and Interests. During the Donor's life, [individual other than the donor, trustee, or a disqualified person as defined in Section 4946(a)(1)] shall have the right, exercisable only in a nonfiduciary capacity and without the consent or approval of any person acting in a fiduciary capacity, to acquire any property held in the trust by substituting other property of equivalent value."

¹⁴⁴Treas. Reg. §1.671-4(b) (2008).

take advantage of a personal exemption.¹⁴⁵ A QDT must be a non-grantor trust. It must be designed to meet the requirements set forth in the IRC¹⁴⁶ and must satisfy the following requirements:¹⁴⁷

- (a) be an irrevocable trust,
 - (b) established “solely for the benefit of”
 - (c) an individual under age 65, and
 - (d) who is disabled as defined in the Social Security Act.
- d. Gift Tax on Funding Trust. To avoid a dispute with the IRS that the funding of the trust is a completed gift, the d(4)(A) SNT should grant the beneficiary a testamentary special (i.e., non-general) power of appointment over the remainder interest upon death.¹⁴⁸
- e. Estate Tax. A d(4)(A) or d(4)(C) SNT is includeable in the beneficiary’s estate for estate tax purposes and the basis of the assets in the trustee’s hands is the fair market value of the property at the date of the beneficiary’s death (or alternative valuation date, if applicable).¹⁴⁹ As a result, if the trust is the beneficiary of a structured settlement, the actuarial value of the structure will be included in the beneficiary’s estate for estate tax purposes. Therefore, Oast & Hook recommends that the structure provide for commutation or lump sum distribution upon the death of the beneficiary to pay estate taxes and the reimbursement due the state. A third party SNT is generally structured so that the trust is not includable in the beneficiary’s estate at the beneficiary’s death. If the d(4)(A) or d(4)(C) SNT has to pay back any state for medical

¹⁴⁵\$3,500 for 2008.

¹⁴⁶IRC §642(b)(2)(C).

¹⁴⁷42 USC §1396p(c)(2)(B)(iv).

¹⁴⁸Treas. Reg. §25.2511-2(c) (2008).

¹⁴⁹PLR 200240018.

assistance provided to the disabled beneficiary, the payback amount is deductible for federal estate tax purposes. IRC section 2053.

J. Investment of Trust Assets

1. Unless the terms of the trust agreement provide otherwise, a trustee of a SNT must:¹⁵⁰
 - a. invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
 - b. diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.
 - c. within a reasonable time after accepting a trusteeship or receiving trust assets, review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this Uniform Prudent Investor Act.
 - d. invest and manage the trust assets solely in the interest of the beneficiaries.
 - e. act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.
 - f. only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.
2. A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. A trustee who acts prudently in making the delegation is not liable to the beneficiaries or to the trust for the decisions or

¹⁵⁰Uniform Prudent Investor Act (“UPIA”)

actions of the agent to whom the function was delegated.¹⁵¹

3. Since the needs of a person with special needs are frequently unique and coordination of trust distributions is complex, the Trustee, should consider:
 - a. Delegating the following to a CERTIFIED FINANCIAL PLANNER™ (CFP®) professional¹⁵²:
 - (1) preparation a budget of necessary trust expenditures,
 - (2) development of an appropriate asset allocation for the trust investments,¹⁵³
 - (3) preparation of an Investment Policy Statement (IPS), and
 - (4) and monitoring the investment performance of the trust assets.
 - b. Using the IPS, delegating the investment management of the trust assets to a Registered Investment Advisor (RIA) .

IX. LITIGATION ASPECTS OF ESTABLISHING SNTs. Self-settled special needs trusts are often used for inheritances, excess funds, and proceeds from personal injury claims.

A. Establishment Process for Inheritances and Excess Funds

1. A person with disabilities may receive an inheritance from a family member. A person may also become disabled later in life and need Medicaid and/or SSI, but have more than \$2,000 in resources. In these situations, a self-settled SNT can help protect the inherited or excess funds during the beneficiary's lifetime. If the beneficiary does not have a living parent, grandparent, or legal guardian, a court will have to establish a (d)(4)(A) or (d)(4)(C) SNT and direct the payment of the beneficiary's funds into the SNT.

¹⁵¹Section 9 of the UPIA and Section 807 of the UTC.

¹⁵²To assist its clients with these tasks, one of the Oast & Hook attorneys obtained his CFP® designation.

¹⁵³The CFP® should consider using a Monte Carlo analysis to determine the likelihood that the trust will be able to fund the budgeted expenses for the beneficiary's projected life expectancy.

2. The attorney must file a petition with the circuit or probate court in the jurisdiction where the beneficiary resides, to have the court establish and fund the SNT. The court will normally want to appoint a guardian *ad litem* to evaluate the beneficiary's interests in the establishment and funding process. The court will normally hold a hearing on the petition, and the court order can permit the Trustee to execute the (d)(4)(A) trust document. The court will normally also sign the (d)(4)(A) trust document or the (d)(4)(C) joinder agreement as the grantor.

B. Establishment and Administration Process for Matrimonial Law¹⁵⁴

1. Approximately 50% of marriages end in a divorce.
2. Self-settled SNTs are frequently established to protect property divisions, spousal support and child support received by persons with disabilities in divorce actions.
 - a. If a spouse with a disability is in a divorce action, any funds awarded by equitable distribution should be paid directly to a Self-settled SNT, rather than directly to the disabled spouse.
 - b. Alimony and spousal support are unearned income.¹⁵⁵ The Alimony or spousal support may be irrevocably assigned to a SNT.¹⁵⁶
 - c. Child support payments made on behalf of a disabled child are unearned income for the child. The court should assign the support payments to a Self-settled SNT.
 - d. To be effective, the assignment of the property settlement, spousal support or child support to the self-settled special needs trust must be irrevocable.
3. Are the assets in a SNT considered in determining the obligation of a parent to provide support for the child? The answer to the question is

¹⁵⁴See Using Self-Settled Special Needs Trusts to Facilitate Matrimonial Settlements, by Begley and Hook, Estate Planning Journal, (April 2007) and Divorce American Style: Divorce, Child Support and SNT's by Neal A. Winston, Stetson Special Needs Trust Conference X, October 17, 2008.

¹⁵⁵POMS SI 00830.418

¹⁵⁶POMS SI 01120.201

especially important since some states impose on parents a continuing support obligation for an adult child with a disability. A Pennsylvania case has held that as a matter of law and public policy the court would not allow a support obligation to be underwritten by a SNT rather than the parents.¹⁵⁷

4. Are Assets in a Self-settled SNT shielded from claims of child support? Generally, the assets of a self-settled trust are not exempt from claims for child support even in states with asset protection trust laws. If the trustee makes distributions for child support on behalf of the disabled person, does it violate the “sole benefit of” rule? There is not clear answer. However, since the refusal to make the distribution may result in contempt charges against the disabled parent beneficiary, it could be argued that the distribution was for his or her benefit and the benefit to the child were incidental.

C. Establishment Process for Personal Injury Claims

1. Self-settled special needs trusts are often established for proceeds from personal injury or medical malpractice claims. Attorneys who are familiar with special needs law should be involved in the claim process as early as possible, particularly if a structured settlement may be considered, to ensure that the settlement will not result in making the beneficiary ineligible for needs-based benefits.
2. Interface with personal injury attorneys. Personal injury attorneys should consult with special needs attorneys early in the process to determine whether a special needs trust is appropriate. The special needs attorney should set up a consultation appointment with the personal injury attorney, and the beneficiary and his or her family to discuss the available options for the claim proceeds. If the claim results in a judgment or settlement order by a court, the special needs attorney should work with the personal injury attorney to include the establishment and funding of the (d)(4)(A) or (d)(4)(C) SNT in the court order. This procedure should be followed even if the parent, grandparent, legal guardian, or beneficiary (for (d)(4)(C) SNTs) actually signs the trust document or joinder agreement as the grantor. The court order can authorize the parent, grandparent, legal guardian, or beneficiary (for (d)(4)(C) pooled trusts), to sign the trust document or joinder agreement as the grantor. Having the court direct the payment of the funds into the SNT avoids potential problems with the SSA regarding the legal authority to transfer the beneficiary’s funds

¹⁵⁷Ricco v. Novitske, 2005 Pa. Super 121, 874 A. 2d 75 (2005)

into the SNT. If the settlement will not require a court order, the settlement agreement should require the defendant to pay the claim proceeds directly to the Trustee of the SNT.

3. Medicaid Liens, Medicare Claims and ERISA Plan Reimbursement Claims

a. Medicaid Liens

- (1) In many tort cases, the beneficiary has received medical care for the injury under the Medicaid program prior to the settlement or disposition of the case. By receiving this care, the Medicaid beneficiary has agreed to repay the state if a recovery is made. Federal law requires the states to take all reasonable measures to ascertain the legal liability of third parties (including health insurers) to pay for care and services paid for by the Medicaid program.¹⁵⁸
- (2) Virtually all states including Virginia and North Carolina¹⁵⁹, impose a lien for goods and services rendered as a direct result of the injury and require notice to be given to the state Medicaid agency by attorneys involved in personal injury, workers compensation and other cases.¹⁶⁰ Additionally, some states have attempted to recover from personal injury settlements the projected future medical expenses that will be paid by the state Medicaid program. The Idaho Supreme Court has held that federal and state laws were not intended to permit the state to recover money meant to compensate the plaintiff for future medical expense.¹⁶¹
- (3) The North Carolina Supreme Court allowed a lien

¹⁵⁸42 USC §1396a (2008).

¹⁵⁹N.C. Gen. Stat. 108A-57a

¹⁶⁰For example, see Virginia Code §8.01-66.9 that imposes a lien in favor of the commonwealth on claims for personal injuries.

¹⁶¹State of Idaho Department of Health and Welfare v. Jonathon L. Hudelson, Docket No. 34495, 2008 Opinion No. 116.

against damages other than medical expenses.¹⁶²

- (4) Although the states may compromise their lien,¹⁶³ the state budget deficits have put additional pressure on them to not compromise their claim.
- (5) The United States Supreme Court has held in the *Ahlborn* decision that the state may only impose its lien on that portion of the judgement or settlement which represents a recovery for those services or care provided by Medicaid.¹⁶⁴ Therefore, states can only assert against that portion of a settlement or recovery allocated to past medical expenses. Therefore, it is good practice in personal injury judgments and settlements to make a clear allocation of damages.¹⁶⁵
- (6) These Medicaid claims/liens must be paid prior to funding a d(4)(A) or d(4)(C) SNT liens.¹⁶⁶
- (7) It frequently takes months to resolve these Medicaid claims/liens issues.

¹⁶²See *Ezell v. Grace Hospital, Inc.* 360 N.C. 529, 631 S.E.2d 131 (June 30, 2006). This seems to contradict the U.S. Supreme Court's decision in *Arkansas DHHS v. Ahlborn* which prohibits states from asserting a Medicaid third-party liability claim against a Medicaid recipient's recovery for personal injury damages other than medical expenses. 126 S. Ct. 1752 (May 1, 2006). The issue is again under review by the North Carolina Supreme Court.

¹⁶³For example see *Garcia v. County of Sacramento*, 103 Cal. App. 4th 6 (2002), and *Commonwealth v. Huynh*, 262 Va. 165, 546 S.E.2d 677 (2001).

¹⁶⁴Arkansas Department of Health and Human Services et Al. V. Ahlborn, 126 S. Ct. 1752 (May 1, 2006).

¹⁶⁵The North Carolina Supreme Court recently upheld North Carolina's statutory method to determine the amount of the state's reimbursement from a tort settlement or judgment for prior medical payments. Section 108A-57(a) provides the state may recover the amount of assistance paid by the state "but the amount paid to the Department shall not exceed one-third of the gross amount obtained or recovered." The Court held that "Rather than requiring a specific determination of medical expense portion of a settlement, North Carolina employs an alternative statutory procedure that we believe is permitted by Ahlborn." See *Andrews v. Haygood*, No. 57A07-2 (12 December 2008).

¹⁶⁶*Payne v. State of N. C. et. al*, 126 N.C. App. 672 (1997).

- (8) Medicaid charges incurred after the funding of the trust must be paid from the trust after the beneficiary's death and prior to any distributions to residuary beneficiary(s).

b. Medicare Claims

- (1) If the beneficiary has received medical care as of the injury under the Medicare program prior to the settlement or disposition of the case, the federal government will assert a claim to be repaid prior to the funding of the
- (2) Counsel should notify the federal government of the settlement or disposition of the case, in order to permit it to ascertain the amount of its claim.
- (3) In cases involving liability insurers, Medicare reduces its recovery to take account of the cost of procuring the judgment or settlement.¹⁶⁷
- (4) The federal government asserts that personal injury attorneys have statutory obligations to affirmatively assist Medicare in its recovery efforts.¹⁶⁸
- (5) In *Zinman V. Shalala*¹⁶⁹, a federal district court held that Medicare had no lien rights with respect to Medicare recovery claims and ordered Medicare to stop using the term "lien" in its collection efforts. Several consequences flow from this holding.¹⁷⁰
 - (a) The personal injury attorney does not owe the federal government the duty to protect its

¹⁶⁷42 CFR §411.37 (2008).

¹⁶⁸42 U.S.C. 1395y(b)(2)(ii) authorizes the United States to bring an action "against any entity" including an attorney that has received any portion of a third party payment directly or indirectly if those third party payments rather than Medicare should have paid for the injury related medical expenses.

¹⁶⁹67 F.3d. 841 (9th Cir. 1995).

¹⁷⁰2009 *Medicare Handbook*, Judith A. Stein and Alfred J. Chiplin, Jr., Aspen Publishers.

recovery claim against his or her client. The client, however, owes the federal government the duty to cooperate and the insurance company owes the duty to notify Medicare.

- (b) If the client chooses to receive his or her portion of the insurance proceeds from his or her attorney and deal directly with Medicare, the federal statute imposes no penalty on the attorney. In any event, Medicare can bring a civil action against the client for recovery.
 - (c) The Medicare statute gives the federal government a right of action to recover from an attorney who has liability proceeds in his or her possession. In contrast, the Medicare statute gives a broader right of action to recover from an insurance company that has transferred proceeds to its insured without paying Medicare. This right of action can be for as much as twice the Medicare claim.
- (6) When a worker's compensation claim is settled for a lump sum, a Medicare Set-Aside Arrangement ("WCMSA") may be required to protect Medicare's interests.¹⁷¹ The federal government has stated that a WCMSA is not subject to any special treatment under the Medicaid resource rules. If the worker is disabled and otherwise eligible for Medicaid, the WCMSA must be designed within a self settled SNT so that the assets are not countable.
- (7) Section 111 of the Medicare, Medicaid and SCHIP Extension Act of 2007¹⁷² requires any entity serving as an insurer or third party administrator for a group health plan to 1) secure information necessary to identify situations where it is or has been a primary plan to Medicare and 2) submit such information to the federal government. This Act imposes civil monetary penalties for the failure to provide this information.

¹⁷¹See http://www.cms.hhs.gov/workerscompagencyservices/04_wcsetaside.asp

¹⁷²See subparagraphs (7) and (8) of 42 USC 1395y(b)

With this information, the federal government may chose to require Medicare Set Aside arranges for all tort cases where the plaintiff is or will be eligible for Medicare and is compensated for future medical claims resulting from the injury.

c. TRICARE Reimbursement Claims.

(1) If TRICARE paid for medical care as a result of an injury, the federal government may also have a claim for reimbursement.

d. ERISA Plan Reimbursement Claims.

(1) It is common for ERISA plans to contain provisions requiring participants and beneficiaries to reimburse the plan if they recover on a claim against a third party in connection with injuries for which the plan paid benefits.

(a) The United States Supreme Court has recently held that a ERISA plan is not permitted to seek reimbursement for \$400,000 of benefits paid to an injured beneficiary from a personal injury settlement.¹⁷³ The court held that the reimbursement action was not equitable relief as required by ERISA. The decision left open the question whether a ERISA plan may sue for imposition of a constructive trust on amounts recovered, if the party being sued is in possession of the recovered amounts.

(b) Some courts have subsequently held that the Supreme Court's opinion does not preclude a health plan's ERISA reimbursement action when the plan sues a plan participant who still has control over the recovered amounts under a constructive trust theory.¹⁷⁴

¹⁷³*Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002).

¹⁷⁴*Admin. Comm. of the Wal-Mart Stores, Inc. v Varco*, 338 F.3d 680 (7th Cir. 2003), and *Forsling v. J.J. Keller & Assocs.*, 241 F. Supp.2d 916 (E.D. Wis. 2003).

4. Settlement of Personal Injury Claims

- a. The settlement of a personal injury claim can be by lump sum, structured settlement, or a combination of both.
- b. For settlements of less than \$100,000, it is frequently advisable that the entire amount be taken in a lump sum, because the cost of creating and administering a small d(4)(A) SNT can be large in relation to the trust assets. In these cases, the lump sum can often be placed into a d(4)(C) SNT or spent down in such a way that will protect public benefits, such as purchase of a home or motor vehicle.
- c. For settlements between \$100,000 and \$500,000, the needs of the person with disabilities must be analyzed to determine whether a portion of the recovery might best be taken in the form of a lump sum and invested in exempt resources and another portion paid to a d(4)(A) or d(4)(C) SNT.
- d. For settlements of \$500,000 or more, it is almost always beneficial to establish a d(4)(A) SNT to manage the funds. The needs of the person with disabilities must be analyzed to determine what portion of the recovery should be structured and what portion should be in a lump sum. The structured portions should contain a commutation provision or payment on death provision, to permit the payment of estate taxes and the Medicaid claim.
- e. For very large settlements, a d(4)(A) SNT might not be necessary when the amount is sufficient to provide for all of the beneficiary's reasonably foreseeable future needs (including medical care and prescription drugs) during his or her lifetime.

D. Essential Special Needs Planning Library The following reference materials are advisable for a Special Needs Planning practice:

1. *Advising the Elderly or Disabled Client* by Lawrence A. Frolik and Melissa C. Brown, published by RIA.
2. *Representing the Elderly or Disabled Client* by Thomas D. Begley, Jr and Andrew H. Hook, published by RIA.
3. *Special Needs Trusts Handbook*, by Thomas D. Begley, Jr. and Angela E. Canellos, published by Aspen Publishers.

4. *2009 Medicare Handbook*, by Stein and Chiplin, published by Wolters Kluwer
5. *Durable Powers of Attorney*, Andrew H. Hook, 859-2nd T.M.
6. Special Needs Alliance website, (www.specialneedsalliance.org). The Special Needs Alliance (SNA) is a non-profit, by invitation only organization of attorneys who represent persons with special needs and their families. The SNA was formed in 2002 and currently has about 103 members from about 47 states.
7. *Elder Law & Special Needs Planning System*; Editors Begley, Hook, Krooks, & Silverberg; published by Interactive Legal Systems, (<http://www.ilsdocs.com>).
8. *Elder Law Column in the Estate Planning Journal*, written by Andrew H. Hook and Thomas D. Begley, Jr and published by RIA .

X. WHAT CONCLUSIONS CAN WE REACH?

- A. Planning for persons with disabilities or special needs is a specialty. This specialty requires in depth knowledge of:
 1. guardian/conservatorship law,
 2. trust law,
 3. public benefits laws,
 4. tax law,
 5. financial planning, and
 6. administrative and trial practice.
- B. Failing to plan to obtain or retain public benefits needed by a person with a disability may give rise to a potential malpractice claim against the attorney.
- C. Special Needs Planning is more than drafting a SNT. It is developing a comprehensive legal and financial plan to address a client's disability and assisting in the implementation of the plan including when appropriate the drafting and funding of a SNT.
- D. When a trial attorney is representing a client with disabilities, he or she should

retain an experienced disabilities/special needs lawyer early in the case to obtain advice and assistance for his client concerning:

1. Available public benefits
 2. Application for needed benefits
 3. Reduction of and satisfaction of Medicare and Medicaid liens and claims
 4. Protection, if necessary, of the client's eligibility for needed benefits using:
 - a. d(4)(A) or d(4)(c) SNTs, or
 - b. alternative strategies
- E. Trial attorneys should counsel the families of clients with disabilities to have their estate plans reviewed and revised if necessary to protect the public benefits of their disabled loved ones.
- F. Estate planning attorneys should ask all of their clients whether any of their beneficiaries have disabilities. If so, they should retain an experienced disabilities/special needs attorney to assist in the preparation of a third party SNT to protect the beneficiary's eligibility for public benefits.
- G. There is no "one" or "standard" form of a d(4)(A) SNT agreement or third party SNT agreement.
1. The trust agreement must conform to federal and state law and be customized to meet the individual needs of the beneficiary with disabilities.
 2. The d(4)(A) SNT must be irrevocable. Simply saying the trust is irrevocable is not enough!
- H. The drafter of a d(4)(A) SNT should:
1. immediately report the creation and funding of the trust to the SSA and local Medicaid eligibility office or make sure that he documents in writing that he has educated the trustee and beneficiary about these rules, and
 2. designate professional trustees who know the SSI, Medicaid and Section 8 housing distribution rules, or document in writing that they

have educated the trustee about these rules.

- I. Serving as a trustee of a d(4)(A) SNT or a third party SNT requires commitment and expertise to retain public benefits and fulfil the terms of the trust agreement, and constant monitoring of changes in public benefits laws (i.e., SSI, Medicaid, etc.) laws, policy and regulations.
- J. Attorneys should not create and administer a d(4)(A) SNTs on an occasional basis.
 1. This practice area requires experience and is not "forms driven."
 2. The attorney should co-counsel with a knowledgeable special needs attorney and/or join professional organizations devoted to assisting persons with special needs or disabilities, such as the Special Needs Alliance,¹⁷⁵ to gain additional training and information.

¹⁷⁵www.specialneedsalliance.org.