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Special Needs Trusts: Detrimental Use of the Sole Benefit Rule

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Comprehensive financial planning is crucial for all families. When a family includes a loved one with special needs, comprehensive planning is of utmost importance. For example, many families with special needs individuals do not know that they need to pay careful attention to the assets of the special needs individual and the method in which gifts or inheritances are received. Families should pay particular attention to the titling of assets, gifting of assets, income earned, and bequests received by the special needs person (Levy, 2010). All of these financial matters can and usually will affect a disabled persons eligibility for Supplemental Security Income (SSI) and most importantly Medicaid. Even though many wealthier families do not think it is worth the hassle of planning to simply get a few hundred dollars a month in Supplemental Security Income from the federal government, they extremely underestimate the value of Medicaid. Medicaid can be of assistance when dealing with the health costs and long term cares expenses for their loved one. While SSI may not provide a substantial amount of money, in many states, Medicaid automatically comes with SSI in many states and minimally lays the groundwork to be eligible for Medicaid in the remaining states. The expenses of nursing home care can quickly deplete assets unnecessarily that should be used to supplement the quality of life of the special needs person rather than paying for long term care facilities.

With proper planning, special needs individuals can have a better quality of life by allowing Medicaid to cover nursing care facilities and by preserving their other assets to maintain status quo. Change is difficult for many people with disabilities. It is particularly important in these cases to take a family approach to planning financially for the special needs person. Within the family, grandparents are often involved in providing non-monetary and monetary support but many caregivers do not involve siblings of those with disabilities in the in

the overall planning process (Graetz, 2010; Heller & Kramer, 2009). Everyone needs to be involved and on the same page to prevent catastrophic errors that can ultimately lead to the loss of benefits. Being on the same page includes family members understanding the proper way to give gifts, or leave inheritances to disabled loved ones. The method in which the gift is made can affect the beneficiary's eligibility for SSI and Medicaid.

Supplemental Security Income (SSI) and Medicaid

SSI is a federal means based program that provides financial assistance to low income individuals. An applicant must be disabled, blind, or over age 65 to qualify for benefits. Since it is a federal program the standards for eligibility are consistent from state to state. However, some states choose to supplement the SSI payments with state funds. Since SSI is a means based program, one must meet both an asset and an income test to determine eligibility (Morton, 2010).

A person is deemed to be disabled under the code if one is, "unable to engage in any substantial gainful activity by reason of nay medically determinable physical or mental impairment which can be expect to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months" (42 U.S.C. 1382c(a)(3)(A)). Since children are unable to hold gainful employment, a different test is used. A person of minority is deemed to be disabled if one "has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months" (42 U.S.C. 1382c(a)(3)(C)(i)). Persons receiving Social Security Disability benefits or Medicaid are also deemed to be disabled (Enea, 2008).

The resource test places a $2000 limit on a single person's assets and $3000 for married persons. Exempt property includes: a home, adjacent land to a home, some household goods and personal affects, one wedding ring and engagement ring, burial plot up to $1500, one automobile regardless of value if necessary for transportation, and life insurance policies with face value of $1500 or less. (Morton, 2010)

The income test considers both earned and unearned incomes and looks to the federal benefit rate (FBR). One's monthly income cannot exceed the FBR as an individual or the FBR plus 33% if married. For 2010, there was no cost of living adjustment and the FBR was held at $674 for individuals and $1011 for married couples (Morton, 2010). The FBR is not only used as the maximum income allowed for eligibility, but it is also the maximum amount of federal SSI payments. The majority of states supplement the federal amount. All states supplement except for Arkansas, Georgia, Kansas, Mississippi, Tennessee, Texas, and West Virginia (Morton, 2010). Some assets are exempt from being a countable income: $20 per month unearned income, $65 per month of wages, 50% of wages over $65 per month, food stamps, and home energy assistance (Drewett, 2010).

The Social Security Administration considers income to include checks, cash, and any deemed income that can be used for food, clothing, or shelter. Do not be mislead that income does not count if it is not income for federal income tax purposes. The standards are different. Wages, business earnings, food, shelter or clothing provided for you, pension payments, annuity payments, life insurance proceeds, court settlements, inheritances, federal and state benefits, rental income, gifts, and more are all considered income. (Drewett, 2010)

Many individuals cannot afford to pay for their own health care and especially for long-term nursing home care. Medicaid provides health care and long-term care benefits for

qualifying applicants based on asset and income tests. Title XIX of the Social Security Act of 1965 promulgated the federal Medicaid program (Eichstadt, 2000). While Medicaid is a federal program, it is adopted and operated by the individual states. Federal law sets forth the basic laws regarding Medicaid eligibility while some states have modified them within their states. To be eligible for Medicaid, generally the applicant must first be eligible for Supplemental Security Income (SSI) meeting both the asset and income tests (Eichstadt, 2000). However, some states have extended Medicaid benefits to individuals other than those that are qualified for SSI while others place additional requirements or income caps to be eligible for Medicaid. (Drewett, 2010).

Medicaid Planning and Asset Spend Down

Asset and income tests must be met to qualify for Medicaid long-term care benefits. For some people, it appears to be too late to plan financially to afford nursing home care. Medicaid is the only realistic option. If one's resources are still above the asset limitations, spending down assets by transferring resources may be a reasonable alternative. However, according to the Omnibus Reconciliation Act of 1993 (OBRA '93) transferring assets triggers a look back and waiting period with a maximum of 36 months due to outright gifts and 60 months due to settling trusts before SSI eligibility begins (Eichstadt, 2000). The Deficit Reduction Act of 2005 (DRA 2005) changed the look back period to be 60 months for both outright gifts and gifts to a trust (DRA 2005). The waiting period is calculated by dividing the transferred amount by the monthly state benefit (Kaplan, 2007). Transfers exempt from triggering the waiting period include gifts to a spouse, blind or disabled person, to a trust for the benefit of a blind or disabled child, or a trust for the sole benefit of a disabled person under the age of 65 (Kaplan, 2007).

While trusts are generally countable assets if the applicant has a legal right to the assets in trust, or even if it not deemed to be a countable asset trusts generally trigger the 60 month look back period. OBRA '93 carved out exceptions to that general rule discussed below. Setting up a Special Needs Trust for the sole benefit of a disabled family member or friend is a very reasonable exception. The Medicaid applicant can transfer his assets into a special needs trust for the sole benefit of a disabled child or for a disabled person under the age of 65. By placing the assets into a Special Needs Trust for the sole benefit of the disable beneficiary, the applicant can transfer away the countable assets and qualify very quickly for benefits without triggering the waiting period (42 U.S.C. Sec.1396p(c)(2)(B)). With proper planning, the applicant can become eligible for SSI and the disabled beneficiary can maintain their current SSI and Medicaid benefits. However, there is much room for error.

Special Needs Trusts

Special Needs Trusts (SNTs), also known as Supplemental Needs Trusts, are used to remove assets out of the name of a mentally or physically disabled individual to allow them to qualify for federal and state government means-based entitlements, such as SSI and Medicaid. They are designed to supplement existing government benefits and not to supplant (Rosenberg, 2000). Drafting of the trusts are of utmost importance to qualify for benefits. SNTs are "generally considered the legal centerpiece of a plan for a disabled person" (Enea, 2008). SNTs are non-countable assets with regard to SSI. There are two main types of SNTs: First Party Self-Settled Trusts and Third Party Trusts. Both types can be non-countable assets with regard to Medicaid. SNTs can be inter vivos, given during life, or testamentary, gifted upon death

(Enea, 2008). Self Settled Trusts are authorized as a Medicaid planning trust by 42 U.S.C. Sec. 1936p(d)(4). The code lays out trust options "A", "B", or "C".

"A" trusts, also referred to D-4A trusts, may be settled with the assets that are owned by the disabled individual under the age of 65. The trust must be created by the parent, grandparent, legal guardian, or the court. It may be used during the life of the special needs person. However, there must be a "Medicaid payback" provision, also known as an estate recovery provision, that requires the trust to reimburse the state Medicaid agency for all expenses incurred on behalf of the disabled person upon the death of the disabled person or second to die spouse. Even though it is unlikely, if there is a remaining corpus of the trust, the chosen beneficiary will inherit the remainder (Drewett, 2010).

A second type of self settled trust is commonly referred to as a "B" Trust, Miller Trust, or a Qualified Income Trust (Drewett, 2010). These trusts are established to assist individuals in states that place an additional income cap on Medicaid recipients. Excess income is transferred into the Miller Trust. Since it is a self settled trust there must be an estate recovery provision within the trust to qualify (Barnes, 2003). These are the least commonly utilized SNTs.

Pooled income trusts, or D-4C Trusts, are held by a nonprofit entity as one large trust on behalf of many special needs beneficiaries (42 U.S.C. Sec. 1936p(d)(4)(c)). The pooled trusts operate similarly to a mutual fund because the beneficiary is given units of participation. Separate accounts are set up for each individual (Enea, 2008). OBRA '93 is silent regarding any age requirement where the other sections require the beneficiary to be under the age of 65. Some states have placed a look back penalty for applicants over 65. D-4C trusts are also non countable assets for SSI. There is an estate recovery provision requirement since it is self settled, but the provision can be avoided if the remainder is a charitable donation to the

nonprofit entity (Drewett, 2010). Pooled trusts are commonly utilized when there are no family members available to act as trustee (Enea, 2008).

Third Party Trusts can provide the best of both worlds. These trusts are funded by money from someone other than that of the disabled person. A Medicaid payback provision is not required as long as the money is not commingled or combined with self-settled assets. The trusts may be revocable or irrevocable by the grantor (Drewett, 2010). Third Party SNTs can direct the remainder to any beneficiary desired (Eichstadt, 2000).

Sole Benefit Trusts (SBTs) and Potential Detrimental Use

As mentioned previously, an applicant for Medicaid benefits may transfer assets to a trust for the sole benefit of a disabled child or a disabled individual under the age of 65 and trigger the look back period (42 U.S.C. Sec. 1396p(c)(2)(B)). This is referred to as a sole benefit trust and when utilized as presented it is a form of a third party SNT. The third party applicant seeking Medicaid qualification can transfer assets into the SBT for the benefit of a disabled person and not trigger any transfer penalty for his or her own Medicaid application. Lump sums or annuity payments can be used to fund the trust as long as it is fully funded by age 21 of the beneficiary (Enea, 2008). However, gift tax and generation skipping transfer tax consequences need to be kept in mind when setting up the trust.

The sole benefit trust is a form of a Third Party SNT. The variance is that many states require that sole benefit SNTs be distributed over the actuarial life expectancy of the special needs person. As mentioned previously, there are both asset and income tests that must be met to maintain qualification for SSI and Medicaid. To allow the trust to qualify as a SBT and not trigger the look back period it must be established where the assets in the trust will be distributed

in a manner that is “actuarially sound” (Enea, 2008). By utilizing the beneficiary’s objective life expectancy, distributions can be calculated to deplete the trust in the necessary actuarially sound manner. This may present a problem for some beneficiaries. OBRA ’93 and the Foster Care Independence Act of 1999 (FCIA) set out exempt SNTs or Pooled Trusts and remove the “actuarially sound” requirement (Enea, 2008).

While an exemption sounds wonderful, there is a downside. Exempt SNTs and Pooled Trusts must be created by a parent, grandparent, legal guardian or court and must have an estate recovery clause paying the state back for Medicaid expenses. Other family members may be the ones needing to establish the SNT to spend down assets for Medicaid eligibility. “It is recommended that a SBT be actuarially sound in order to maintain its flexibility” (Enea, 2008). Therefore, the payments would need to be distributed over the life expectancy of the disabled beneficiary. The amount of the distributions can present a problem for the beneficiary.

The important question to ask is whether the beneficiary is concerned or should be concerned about eligibility for SSI and Medicaid now or in the future. If there is no concern in this case it is a perfect situation for both the applicant transferring the property into the SBT and the disabled beneficiary. However, if the beneficiary is concerned about benefits eligibility there is a potential predicament. If the trust requires large distributions of income to meet the payout requirement then the Medicaid recipient may become ineligible. In this situation, the applicant is able to quickly qualify for Medicaid, but the gift will most likely be detrimental to the special needs person. It can disqualify the special needs person from benefits. Loss of Medicaid benefits is of utmost concern.

A win-win situation can transpire if the special needs person is not on the means-based SSI and Medicaid. The distributions will not affect Social Security Disability Income (SSDI) and Medicare because these entitlements do not have the strict income and asset requirements.

Conclusion

SBTs can be useful as a Medicaid spend down tool for seniors that do not want to trigger the waiting look back period. Careful attention needs to be paid to the impact of the special needs beneficiary. If the beneficiary is a recipient of SSI, it may cause more harm than good to the beneficiary, but the applicant will still benefit from the transfer regarding eligibility. However, if they are not SSI recipients or ever concerned about becoming eligible, it could be a perfect situation for both the applicant needing Medicaid and the special needs beneficiary.

Education is tantamount in any area of financial planning, but even more pressing when it comes to special needs planning. Heller (2000) and Smith & Tobin (1989) found that both families and professionals lack the necessary information on regulations, rights and benefits to make effective choices for their children. By understanding the factors which affect this area, the regulations, eligibility requirements and current tax laws, financial and estate planners can better understand the structuring of special needs trusts. They will pay particular attention to the interaction between Medicaid, Medicare, SSI, SSDI, and other income resources (Sharpe & Baker, 2007). Elder law attorneys are among professionals equipped with the training to assist with the legal needs of elderly adults with disabilities (Arnason, Fish & Rosenzweig, 2001), as well as families with special needs individuals.

References

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