

WHAT TRIAL LAWYERS NEED TO KNOW ABOUT SPECIAL NEEDS TRUSTS AND DISABILITY PLANNING

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Disabled individuals have unique needs. Frequently, expensive health care or caregiver services are among those needs. Without proper planning, resources secured by trial counsel through verdict or settlement may be quickly dissipated paying for health care and caregiver expenses. In short, without proper planning, trial lawyers may not enhance the client's quality of life at all; they may simply "rob Peter to pay Paul."

Eligibility for most public benefits programs is linked to the applicant's financial circumstances. Typically eligibility hinges either on income or on income and assets. Moreover, if someone is receiving public benefits at the time of verdict or settlement, liens may exist which must be satisfied.

Eligibility issues can be dealt with, in most cases, with a special needs trust, sometimes called a supplemental needs trust ("SNT"). SNTs are creatures of federal law and, therefore, they must meet applicable statutory criteria. They must be (1) created by a parent, grandparent, guardian or court,¹ (2) must

¹ For any number of reasons, including State laws requiring authorization for settlement of an incompetent's claim, Court approval may be desired. For example, the Supplemental Security Program sometimes applies an overly technical interpretation of subsection 1396(d)(4)(A). The subsection does not allow the beneficiary to establish the trust and SSI sometimes equates

specify that upon the beneficiary's death, government will be repaid, at least for the medical assistance (Medicaid) provided, and (3) must be irrevocable. 42 U.S.C.A. §1396p(d)(4)(A) and 42 U.S.C.A. § 1382b(e)(5).² State regulations may add other requirements. For example, many State Medicaid programs require an annual or semi-annual accounting.

The remainder of this paper reviews fundamental concepts associated with SNTs.

SNTs are used to benefit a person with a disability. The trust provides instructions on how to manage money that is being set aside to help care for a disabled person. These Trusts allow an unlimited amount of money to be held for the benefit of a disabled person without disqualifying the disabled person from benefits provided by federal and state support programs.

funding with establishment. They also treat an agent as the individual himself or herself. Thus, gaining Court approval might address two issues (1) avoiding confusion about which hat someone is wearing when acting for the beneficiary (agent vs. parent); and (2) the source of authority to fund the trust.

² This form of trust is a self-settled SNT. Other criteria apply as well, for example, the beneficiary of a self-settled SNT cannot be 65 or older at the time the trust is created or funded. These restrictions do not apply to third party trusts (*e.g.*, where a child establishes a trust for a parent).

SETTLEMENT ISSUES

This paper focuses on SNTs. However, other settlement issues must be taken into account after settlement or verdict, including the following:

- *Medicare Liens*: The Medicare Secondary Payer Act, 42 U.S.C. § 1395y (“MSP Act”), imposes what some call a “superlien” on funds secured by an injured Medicare beneficiary from a responsible third party if Medicare paid medical bills. Attorneys who ignore this lien do so at their own peril because the MSP Act essentially makes each person touching the money liable for payment of Medicare’s claim. At this time, Medicare concerns are limited to prior medical expenses unless the injury arose in the context of worker’s compensation. To ensure future Medicare eligibility, a Medicare Set-Aside Trust is often used. Articles concerning the MSP Act are available through the ATLA Exchange. The National Alliance of Medicare Set-Aside Professionals is an organization of professionals who address these claims. See <http://www.namsap.org>.
- *Medicaid Liens*: If the client was receiving Medicaid prior to the settlement or verdict, then Medicaid will have a lien against proceeds secured from a responsible third party. This lien is secondary to the Medicare lien, but almost as onerous. More significantly, while the Medicare lien is limited to repayment of prior medical expenses funded by that program, the Medicaid lien is not. Medicaid potentially reaches the entire settlement, up to the full amount paid by the Medicaid program through the date of recovery. As of this writing, this issue is on appeal to the U.S. Supreme Court. With luck, we will have an answer by the time this seminar is presented. *Arkansas Department of Human Services v. Ahlborn*, 397 F.3d 620 (8th Cir. 2005), cert. granted September 27, 2005.
- *Subrogation Claims*. Subrogation law varies from State to State with some applying a made-whole doctrine. This issue should be analyzed, but is not addressed herein.
- *Continued SSI Eligibility*. Supplemental Security Income provides low income disabled or aged individuals with a stipend to pay for food, clothing and shelter. Eligibility is means tested. Receipt of a recovery may cause the SSI beneficiary to lose eligibility. If SSI eligibility issues are disregarded, then the client may lose up to \$579 per month (in 2005) that could have paid for basic living needs. Placing the recovery in an SNT could maintain eligibility.
- *Medicaid Eligibility*. Medicaid pays for basic medical care for individuals with low income and limited assets. Medicaid eligibility can be maintained by placing the recovery in a properly structured SNT. Another option is traditional Medicaid Planning.³ Estate Recovery and SNT payback issues should be considered, although in

³ As of this writing (November 2005), legislation is pending in Congress that would limit Medicaid Planning opportunities.

this writer's view, the interests of potential heirs are secondary to the needs of the client.

WHY USE AN SNT?

Ordinarily, an SNT is used when (1) the actual or potential cost of meeting an individual's basic life needs (food, clothing, shelter and medical care) exceeds the value of resources available to the individual; and (2) placing the available resources into the SNT would accelerate eligibility for public benefits. Under these circumstances, the SNT assets are preserved to meet the individual's supplemental, or quality of life needs, before they are exhausted; if the individual's assets were exhausted, rather than preserved, then the individual would have no funds for quality of life needs (and a rather bland "existence-type" life).

Situations where an SNT (of some form or variety) might be considered include the following:

1. A disabled individual settles litigation and places the proceeds into a d4A or d4C trust to maintain eligibility for public benefits.
2. An individual becomes disabled while owning resources and wants to become eligible for public benefits while preserving resources for his/her own quality of life needs (d4A or d4C), or by placing them in a sole benefit trust to meet the quality of life needs of another disabled individual.
3. An Individual is already on public benefits and receives an inheritance (d4A or d4C).

4. An individual, or group of persons, wish to provide for the quality of life needs of a disabled person for whom they have no *legal* obligation to provide support (third party SNT or testamentary SNT).
5. An individual converts an exempt asset (e.g., the home) into cash and now has countable assets that would impair benefits eligibility (d4A or d4C).

In addition, where assets that would fund the trust are revolving assets (e.g., a structured settlement that is paid out each month), or where there is no corporate fiduciary willing to serve as trustee, the "pooled trust" form should be considered to avoid diminishing the trust with administrative costs. Smaller amounts (less than \$100,000) should almost always be placed in a pooled trust to limit administrative costs and ensure proper management.

LEGAL CONSIDERATIONS

A trust is a *supplemental* (or special) needs trust when (1) it is irrevocable;⁴ and (2) the duties imposed on the trustee are defined to grant the trustee *discretion* to provide for quality of life needs, but also include discretion to refuse to pay for basic life needs (e.g., food, clothing, shelter and medical care) that may be provided through public benefits programs such as SSI or Medicaid (hereinafter supplemental, or special, needs trusts are referred to as SNT or SNTs).⁵ The purpose of the SNT is to

⁴ 42 U.S.C. § 1396p(d)(3).

⁵ Note that discretion, alone, is insufficient. The trust assets must be structured so no portion of the income or corpus is deemed "available" to the beneficiary. 42 U.S.C. § 1396p(d)(3) and (4).

supplement, not supplant, government benefits.⁶ To fully achieve this goal, every SNT is, to some extent, a spend-thrift trust. See O.C.G.A. § 53-12-28; *Avera v. Avera*, 253 Ga. 16, 18 (1984) (While we acknowledge there is a discretion in the trustee to encroach upon the corpus, we note he may do so only in the limited circumstances of "misfortune, illness, accident or infirmity," and for necessary sums when there are no other "funds reasonably available" to meet the particular need. This provision does not empower the trustee to invade the corpus with unlimited discretion).⁷ See also POMS SI 01120.200.D.1.a.

Historical information concerning the development of these trusts appears in C. Kruse, *Third-Party and Self-Created Trusts: Planning for the Elderly and Disabled Client, Third Edition*, pp. 3-8 (ABA 2002).

⁶ A supplemental needs trust is a type of trust that limits the trustee's discretion as to the purpose of the distributions. This type of trust typically contains language that distributions should supplement, but not supplant, sources of income including SSI or other government benefits. POMS SI 01120.200.B.13. A trust may be created for any lawful purpose. O.C.G.A. § 53-12-23.

⁷ See O.C.G.A. § 53-12-28(c): Except as otherwise provided in this subsection, a spendthrift provision prohibiting involuntary transfers is valid and enforceable. Except with regard to a community trust established pursuant to Chapter 10 of Title 30, a spendthrift provision prohibiting involuntary transfers is not valid if the beneficiary is the settlor. A spendthrift provision prohibiting involuntary transfers is not valid as to the following claims against a distribution to a beneficiary, other than a beneficiary who has a medically determined physical or mental disability that substantially impairs the beneficiary's ability to provide for the beneficiary's care or custody and constitutes a substantial handicap or in the case of a life beneficiary of a community trust, to the extent the distribution would be subject to garnishment under the laws of this state if the distribution were disposable earnings:

- (1) Tort judgments;
- (2) Taxes;

SNTs are for disabled individuals. The definition of disability used in this context is the same one by the Social Security Administration to determine eligibility for Supplemental Security Income ("SSI") or Social Security Disability ("SSD") benefits. See 42 U.S.C. §1382c(a)(3)(A), which states that "[a]n individual shall be considered to be disabled for purposes of this subchapter if he is unable to engage in any substantial, gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity)."

SNTs can be categorized into five distinct types, each varying somewhat regarding how they are structured, and their legal effect. The two most common are authorized pursuant to sections 1917(d)(4)(A) and (C) of the Social Security Act (the Act) (42 USC § 1396(d)(4)(A)⁸ and (C)).⁹ These trusts are

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- (3) Governmental claims;
 - (4) Alimony;
 - (5) Child support; or
 - (6) Judgment for necessities not voluntarily provided by the claimant.

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

⁹ 42 U.S.C. § 1396p(d)(4)(C) provides: A trust containing the assets of an individual who is

sometimes called self-settled SNTs. The others are (1) sole benefit SNTs;¹⁰ (2) third-party SNTs;¹¹ and (3) testamentary SNTs.¹² The trusts mentioned thus far protect assets. A sixth type of trust, used to bring excess income under the income cap for Medicaid eligibility in some states, is a qualified income trust.¹³

Self-settled SNTs can be individually created for persons under the age of Sixty-Five (65). For those who are 65 or older, a pooled trust sub-account is the only option. Individual trusts are sometimes referred to as “d4A” trusts (a

disabled (as defined in section 1382c (a)(3) of this title) that meets the following conditions: **(i)** The trust is established and managed by a non-profit association. **(ii)** A separate account is maintained for each beneficiary of the trust, but, for purposes of investment and management of funds, the trust pools these accounts. **(iii)** Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in section 1382c (a)(3) of this title) by the parent, grandparent, or legal guardian of such individuals, by such individuals, or by a court. **(iv)** To the extent that amounts remaining in the beneficiary’s account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this subchapter.

¹⁰ 42 U.S.C. 1396p(c)(2)(B)(iv) provides that an individual shall not be ineligible for medical assistance to the extent that assets “were transferred to a trust (including a trust described in subsection (d)(4) of this section) established solely for the benefit of an individual under 65 years of age who is disabled (as defined in section 1382c (a)(3) of this title.”

¹¹ If the trust is properly drawn to avoid vesting any right to receive or control the trust, then these trusts are exempt because they do not contain assets of the benefits applicant. See 42 U.S.C. § 1396p(d)(3) in considering how to avoid vesting rights in the beneficiary.

¹² Testamentary trusts are exempt from the trust transfer rules consistent with the “other than by Will” language at 42 U.S.C. § 1396p(d)(2)(A).

¹³ 42 U.S.C. § 1396p(d)(4)(B).

reference to the federal statutory authority) and pooled trusts are “d4C” trusts. Each, if properly drafted, shields resources that would otherwise be counted in determining eligibility for Supplemental Security Income (SSI) and/or Medicaid.

TRUST ADMINISTRATION

Although this paper does not deal exhaustively with trust administration, that aspect of the trust process cannot be overlooked and the trustee selected must be someone who is either familiar with government benefits programs, or who has retained professional help. Improper administration can result in a loss of benefits. Most commonly, improper distributions can be deemed as “income” for the beneficiary, which – if over the program thresholds -- could result in the loss of public benefits. In general terms, the following is a non-exhaustive list of items that can be purchased with trust assets:

- A home, including adjacent land, if the beneficiary lives there or intends to return to it;¹⁴
- Health and dental treatment and equipment for which there are not funds otherwise available;
- Rehabilitative expenses and occupational therapy services;
- Medical and diagnostic treatment beyond Medicaid benefits, even though not medically necessary or lifesaving;
- Medical insurance premiums;
- Supplemental nursing care;
- Supplemental dietary needs;

¹⁴ Note, however, that disbursements for food, clothing and shelter may reduce SSI income. See *Hecht v. Barnhart*, 68 Fed.Appx. 244 (2nd Cir. 2003).

- Eyeglasses;
- Travel;
- Entertainment;
- Companionship;
- Private case management;
- Cultural experiences;
- Expenses associated with bringing relatives or friends to visit with the beneficiary;
- Vacations;
- Movies;
- Telephone service and answering machines;
- Television and cable equipment and services;
- Radios, stereos and musical instruments;
- Training and education programs;
- Caretaker Expenses;
- Recreation, entertainment and travel for the beneficiary and a caretaker;
- Purchase of furniture for the beneficiary;
- Purchase of an automobile for transportation to medical treatment;
- Renovations to a house to adapt to the needs of the beneficiary;
- Cost of adapting a car or van to the needs of the beneficiary;
- Reading and educational materials;
- A burial plot and pre-paid burial expenses.

support of unmet needs. In other words, SNTs are discretionary trusts and, as such, the choice of trustee is critical. If the trust is properly drafted and an appropriate trustee is chosen, the result will be a higher quality of life for the beneficiary because Medicaid and SSI will meet basic life needs, while the trust finances those things that put a smile on the beneficiary's face and make life worth living.

If you have special needs clients who have or will require continued benefits eligibility, members of the National Academy of Elder Law Attorneys are typically familiar with public benefits programs and can assist in planning. A tool for locating an Elder Law attorney near you is at www.naela.org.

CONCLUSION

An SNT must be drafted to eliminate any "duty" to support the beneficiary, and should be drafted to permit broad