

**DRAFTING SPECIAL NEEDS TRUSTS:  
WHAT YOU NEED TO KNOW**

by

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## I. PUBLIC BENEFIT PROGRAMS

Special needs trusts are necessary to preserve the beneficiary's public benefits. The principal government benefit programs affecting the disabled are:

- (a) *SSI.* SSI is an income maintenance program. The purpose of the SSI payment is to provide the recipient with income to be used for food and shelter.<sup>1</sup> It is designed to provide recipients with 75% of the federally-defined poverty level. For 2007, the maximum federal SSI monthly payment for an individual is \$623 per month.<sup>2</sup> This is known as the Federal Benefit Rate. Many states provide a small supplement to the federal benefit. SSI is a means-tested program with eligibility requirements including income and resource eligibility.
- (b) *Medicaid.* Medicaid is a welfare program that pays medical bills for the aged, blind and disabled who meet certain requirements. It is a medical payment program, not a medical insurance program. Medicaid is means tested with both income and resource eligibility requirements. The Medicaid law is Title XIX of the Social Security Act.<sup>3</sup>
- (c) *SSD.* SSD is a disability income insurance program. During an individual's working career, payments are made into the system and if the worker is disabled, he or she is entitled to SSD. The amount of the monthly payment depends on the amount the worker paid into the system. Under certain circumstances, a worker's spouse or disabled children may be entitled to SSD based on the worker's record. Since SSD is an insurance program, it is not means tested.
- (d) *Medicare.* Medicare is a medical insurance program. Like SSD, the worker pays into the system during his or her working career and is entitled to Medicare, if he or she subsequently becomes disabled. Generally, an individual must wait two years after a determination of disability by the Social Security Administration before becoming eligible for Medicare. Again, since the program is an insurance program, it is not means tested.

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<sup>1</sup> 20 C.F.R. §416.110.

<sup>2</sup> 42 U.S.C. §1382f(a).

<sup>3</sup> 42 U.S.C. §1396 and 42 C.F.R. Parts 430, 431 and 435.

- (e) *Section 8 Housing.* Section 8 of the Housing Act of 1937 provides for a rental assistance program for low-income families and individuals. There are several programs depending on the income level of the applicant, but generally a family pays approximately 30% of adjusted monthly income for rent. Section 8 Housing is not necessarily “project based.” It may be “tenant based.” The tenant selects a unit and Section 8 pays a portion of the rent. The goal is to scatter Section 8 Housing throughout communities to avoid the creation of ghettos.

Section 8 Housing is income tested, not resource tested. However, income from resources is counted as income to the tenant and if the tenant transfers resources, income is imputed to the tenant at the rate of 2% per year. If a Special Needs Trust is established by a third party and the tenant does not have access to income, the income is not counted for purposes of eligibility or rent calculation. However, if income from the trust is paid to the beneficiary regularly, those payments are counted as income.<sup>4</sup> In the case of a Third Party Special Needs Trust, the provisions pertaining to regular income apply, and, in addition, income is imputed on the transferred assets for a period of two years after the date of the transfer. To avoid inclusion of income, payments from the Special Needs Trust need to be irregular and sporadic.

## **II. TWO TYPES OF SPECIAL NEEDS TRUSTS**

### **A. Third Party Trusts**

The first type is a third party special needs trust, which is established by the third party with assets of the third party for the benefit of a disabled person. Typically, these trusts are established by a parent for the benefit of a disabled child. There is no requirement that the state Medicaid agency be paid back funds on the death of the beneficiary. However, as discussed below, the income from the trust must not be considered available to the beneficiary or the income may push the beneficiary over the public benefit income limit and disqualify the beneficiary from receiving the benefits. Similarly, the assets in the trust must not be available to the beneficiary. There is great flexibility in structuring the trust to achieve the income gift and estate tax goals of the settlor.

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<sup>4</sup> Occupancy Requirements of Subsidized Multi-Family Housing Programs §5.7 G 1 c A (2).

There is no federal statutory authority for a third party special needs trust. However, authority is found in the POMS at POMS § SI 01120.200 *et seq.*

**B. Self-Settled Trusts**

The federal statutory authority for a self-settled special needs trust is found at 42 U.S.C. § 1396p(d)(4)(A) and at HR 3443 Foster Care Independence Act of 1999 § 205.<sup>5</sup>

A self-settled special needs trust, commonly referred to as a (d)(4)(A) trust, is established with the assets of the disabled person. It must be established by the parent, grandparent, guardian of the disabled person, or by a court. Only the disabled person can be the beneficiary of the trust. These trusts are frequently used when an injured party receives money as a result of a tort action. The trust must be an inter vivos trust, rather than a testamentary trust, and it must be irrevocable. Prior to establishing the trust the attorney must be concerned with the existence of any Medicare claim and Medicaid lien as well as claims for reimbursement from third party liability insurers. The trust cannot be established if the beneficiary is over age 65. On the death of the beneficiary assets remaining in the trust must be used to pay back any state Medicaid agency providing benefits. There is considerably less flexibility with respect to achieving tax goals.

**Special Needs Trust Comparison**

<i>Issue</i>	<i>Third Party SNT</i>	<i>Self-Settled SNT</i>
Established By	Third Party	Parent, Grandparent, Guardian, or Court
Funded by Assets of	Third Party	Disabled Person
Beneficiary Only	Disabled Person and Nondisabled Person	Disabled Person
Grantor Trustee	Yes	No
Discretionary	Yes	Yes
Inter Vivos	Yes	Yes
Testamentary	Yes	No
Revocable	Can Be	No
Grantor Trust	Can Be	Yes
Gift Tax Annual Exclusion	Can Use	Cannot Use

<sup>5</sup> 42 U.S.C. § 1382(b).

<i>Issue</i>	<i>Third Party SNT</i>	<i>Self-Settled SNT</i>
Estate Tax	Can Be Excluded	Includable
Distributions	Payments to Third Parties	Payments to Third Parties
Disability	SSA Definition	SSA Definition
Pay Back Provision	No	Yes
Medicare Claim	No	Yes
Medicaid Lien	No	Yes
Age Limit	None	65

### III. COMMON REQUIREMENTS

Both third party special needs trusts and self-settled special needs trusts have certain common requirements.

Special needs trusts are used to supplement the beneficiary's lifestyle rather than to supplant public benefits. The public benefits typically involved include SSD, Medicare, and free public education which are not means-tested, and SSI, Medicaid, Section 8 Housing, and other state social services which are means-tested. By establishing a special needs trust, the funds in the trust are made “unavailable” and do not affect the means-tested programs. There is no need for a special needs trust if means-tested programs are not anticipated. While some states provide social services without regard to financial need, other charge disabled people with means for the benefits provided.

Other programs typically involved which might require a special needs trust to retain benefit eligibility include food stamps, Energy Assistance, Vocational Rehabilitation Programs, Recreational Programs, Developmental Disabilities Programs, etc. Additionally, there may be state “waiver” programs or medical or related services in given states.

#### A. Disability

The definition of disability for special needs trusts is the same definition contained in the Social Security Act for determining eligibility for SSI or SSD.

## **B. POMS Considerations When Drafting A Special Needs Trust**

A special needs trust requires a design that takes into consideration the Program Operations Manual System (POMS), which is published by the Social Security Administration (SSA) and contains the operating procedures for SSI. The POMS recognize the trust device. In fact, the POMS contain the following definition of a trust: “A trust is a property interest whereby property is held by an individual or entity (such as a bank) called the trustee, subject to a fiduciary duty to use the property for the benefit of another (the beneficiary).”<sup>6</sup>

SSA Transmittal No. 35 dated February 2001 contains a number of important definitions in addition to the definition of trust.<sup>7</sup>

### **1. Grantor**

A grantor (also called a settlor or trustor) is the individual who provides the trust principal (or corpus).<sup>8</sup>

### **2. Trustee**

A trustee is a person or entity who holds legal title to property for use of the benefit of another. In most instances the trustee has no legal right to revoke the trust or use the property for his/her own benefit.<sup>9</sup>

### **3. Trust beneficiary**

A trust beneficiary is a person for whose benefit a trust exists. A beneficiary does not hold legal title to trust property but does have an equitable ownership interest in it.<sup>10</sup>

### **4. Grantor trust**

A grantor trust in which the grantor of the trusts is also the sole beneficiary of the trust.<sup>11</sup>

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<sup>6</sup> Social Security Administration Program Operations Manual System (POMS) § S.I. 01120.200.B.1.

<sup>7</sup> POMS § S.I. 01120.200 B.

<sup>8</sup> POMS § S.I. 01120.200 B 2.

<sup>9</sup> POMS § S.I. 01120.200 B 3.

<sup>10</sup> POMS § S.I. 01120.200 B 4.

<sup>11</sup> POMS § S.I. 01120.200 B 8.

## **5. Definition of discretionary trust**

The POMS defines a discretionary trust as “a trust in which the trustee has full discretion as to the time, purpose and amount of all distributions. The trustee may pay to or for the benefit of the beneficiary, all or none of the trust as he or she considers appropriate. The beneficiary has no control over the trust.”<sup>12</sup> The key to the entire issue of “availability” is the discretion of the trustee. If the beneficiary has no right to compel distribution or to revoke the trust, the trust is discretionary and the trust assets will be unavailable.

## **6. Residual beneficiary**

Whether the trust has named a residual beneficiary is important in some states in determining whether or not the trust is revocable and, therefore, available. A residual beneficiary is defined as “not a current beneficiary of a trust, but will receive the residual benefit of the trust contingent upon the occurrence of a specific event, e.g., the death of the primary beneficiary.”<sup>13</sup>

The Social Security Administration (SSA) follows state law in determining whether or not a trust is revocable. Most states follow the general principle that if a grantor is also the sole beneficiary of the trust, the trust is revocable, but if there is a named “residual beneficiary” then the trust then the trust is irrevocable.<sup>14</sup> Therefore, in a situation where there is a self-settled trust, the grantor is typically the sole beneficiary and a residual beneficiary must be named.

## **7. Supplemental needs trust**

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 governmental benefits.<sup>15</sup>

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<sup>12</sup> POMS § S.I. 01120.200 B 10.

<sup>13</sup> POMS § S.I. 01120.200 B.12.

<sup>14</sup> POMS § S.I. 01120.D(3).

<sup>15</sup> POMS § S.I. 01120.200 B 13.

## **8. Third party trust**

A third party trust is a trust established by someone other than the beneficiary as grantor.<sup>16</sup> An Ohio court held that a non-self-settled trust in which the Medicaid recipient was beneficiary could not be considered in determining Medicaid eligibility. The trust was a third party special needs trust established by the mother with the mother's own resources and a disabled child as beneficiary.<sup>17</sup>

## **9. Trusts assets as resources**

The POMS discusses trust assets as resources as follows” “If an individual (claimant, recipient, or deemor) has legal authority to revoke the trust and then use the funds to meet his food, clothing 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.”<sup>18</sup> Again, the test is clearly whether the beneficiary has a right to revoke the trust or compel distributions.

### **a. Revocation**

In a third party special needs trust, revocation is not usually an issue, because the grantor and the beneficiary are different and a residual beneficiary is named to take the trust assets upon the death of the beneficiary. The beneficiary, therefore, has no authority to revoke the trust. In the self-settled trust the grantor and the beneficiary are the same and the trust contains a payback provision for Medicaid. Drafters do not always include a residual beneficiary and, therefore, revocation becomes an issue. The POMS state:

A beneficiary generally does not have the power to revoke a trust. However, the trust may be a resource of the beneficiary, in the rare instance, where he/she has the authority under the trust to direct the

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<sup>16</sup> POMS § S.I. 01120.200 B 17.

<sup>17</sup> *Carnahan v. Ohio Department of Human Services*, 139 Ohio App. 3d 214, 743 N.E. 2d 473 (2000), *EISP appeal to Supreme Court of Ohio denied*, 91 Ohio St. 3d 1448, 742 N.E. 2d 146 (2001).

<sup>18</sup> POMS § S.I. 01120.200.D.1.a.

use of the trust principal. (The authority to control the trust principal may be either specific trust provisions allowing the beneficiary to act on his/her own or by ordering actions by the trustee.) In such a case, the beneficiary's equitable ownership in the trust principal and his/her ability to use it for support and maintenance means it is a resource.<sup>19</sup>

This would apply to a support trust where the beneficiary would have the right to compel distributions from the trust to or on behalf of the beneficiary.

**b. Availability**

The POMS recognize a two-pronged test for purposes of determining “availability.” If the beneficiary of the trust has no right to revoke the trust or to direct the use of trust assets for his or her own support and maintenance, the trust principal is not an available resource.<sup>20</sup>

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 cannot be used by an individual for support and maintenance, it is not a resource. This provides the legal basis for a special needs trust.

**10. Distributions from trust**

A special needs trust must not only be properly drafted and funded, but it is crucial that it also be properly administered. Improper distributions from a properly drafted and funded trust can cause the loss of public benefits to the beneficiary of the trust.

**Example:** Jill is the trustee of a special needs trust established by her deceased mother, Paula, for the

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<sup>19</sup> POMS § S.I. 01120.200.D.1.b.

<sup>20</sup> *Id.*

benefit of Paula's daughter, Anne. Anne's living expenses, including rent, food, transportation, and clothing, total approximately \$2,000 per month. Jill sends Anne a check on the first of every month for \$2,000 so that Anne can pay her expenses. Since Anne is receiving cash income in excess of her monthly SSI payment of \$552, she loses her SSI. Since Anne received Medicaid based on her SSI payment, she also loses Medicaid.

**a. Income**

The POMS provide: “If the trust principal is not a resource, disbursements from the trust may be income to the SSI recipient beneficiary, depending on the nature of the disbursements.” Regular rules to determine when income is available apply.<sup>21</sup>

The POMS further provide: “Cash paid directly from the trust to an individual is unearned income.”<sup>22</sup> Therefore, it is crucial for the trustee of a special needs trust to have a clear understanding of the SSI income rules and to limit distributions to those expenditures that are appropriate.

**Example:** Jill, a disabled adult person, is receiving SSI. Joan is the trustee of a special needs trust established by Jill's parents for her benefit. Jill likes to read the *New York Times*. Joan arranges with the local newspaper distributor to deliver the *New York Times* to Jill on a daily basis, including Sundays, and pays the bill directly to the newspaper distributor. This is not considered income to Jill.

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<sup>21</sup> POMS § S.I. 01120.200.E.1.

<sup>22</sup> POMS § S.I. 01120.200.E.1.a.

**b. In-kind support and maintenance**

Disbursements that result in receipt of In-Kind Support and Maintenance (ISM) are defined as food or shelter received as a result of disbursements from the trust by the trustee to a third party in the form of in-kind support and maintenance and are valued under the presumed maximum value (PMV) rule.<sup>23</sup> It is often appropriate to make ISM payments and for the beneficiary to have a reduction in benefits. Therefore, a trust document might contain language authorizing the trustee to make distributions for “food and shelter” for the beneficiary. The SSI monthly payment may be inadequate to provide the appropriate level of food and shelter for the beneficiary. As long as the SSI payment is maintained, although at a reduced level, Medicaid eligibility is maintained.

**c. Third party non-income payments**

Since these distributions do not result in any reduction of SSI benefit, they are the most desirable types of distributions for a trustee to make. It is important that the distributions be made directly to the third party, not to the trust beneficiary. The POMS state: “Disbursements from the trust by the trustee to a third-party that result in the individual receiving items that are not food, clothing or shelter are not income. For example, if trust funds are paid to a provider of medical services for care rendered to the individual, the disbursements are not income for SSI purposes.”<sup>24</sup>

These rules are the basic rules for trust administration and define what distributions can be made from a trust and the impact of such distributions on the SSI benefit of the trust beneficiary. It is crucial that trustees are aware of these rules.

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<sup>23</sup> POMS § S.I. 01120.200E.1.b.

<sup>24</sup> POMS § S.I. 01120.200.E.1.c.

#### **IV. THREE MAJOR ISSUES INVOLVED IN A SPECIAL NEEDS TRUST**

The three key issues in both types of special needs trusts are: availability, transfer rules, and pay back requirements.

##### **A. Availability**

###### **1. Trustee's discretion**

Assets held in a properly-drafted special needs trust are not available to the disabled beneficiary. If the assets in the trust are available, the beneficiary loses public benefits. If the assets are unavailable, they are not considered in determining public benefits eligibility.

The key as to whether or not the trust assets will be held to be available is the *discretion* of the trustee. Under the POMS trust assets are available if the individual has the legal authority to direct a distribution from the trust for his or her support and maintenance or has the right to revoke the trust.<sup>25</sup> Therefore, assets held in a discretionary trust are not available. The POMS defines a discretionary trust as “a trust in which the trustee has full discretion as to the time, purpose and amount of all distributions. The trustee may pay to or for the benefit of the beneficiary all or none of the trust as he or she considers appropriate. The beneficiary has no control over the trust.”<sup>26</sup> Therefore, the discretion of the trustee determines availability of trust assets.

Central to the issue of availability is the *distribution standard* used in the trust document.<sup>27</sup> If the distribution standard is too broad, the trust may be considered an available resource in some states. If the distribution standard is too narrow, the trustee is restricted from making distributions for the maximum benefit of the beneficiary. There are six types of distribution standards:

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<sup>25</sup> POMS § SI 01120.200D 1 (a).

<sup>26</sup> POMS § SI 01120.200B.10.

<sup>27</sup> Cynthia Barrett, “Distribution Standard for the Special and Supplemental Needs Trust,” NAELA Quarterly (Summer 2001).

- *Support Trusts* - These are treated as available resources.<sup>28</sup>
- *Fully Discretionary Trusts* - These may or may not be available depending on state law.<sup>29</sup>
- *Discretionary Support Trusts* - These may or may not be available depending on state law.
- *Distributions for ISM* - Distributions for food, clothing and shelter are considered distributions for in-kind support and maintenance (ISM). These distributions will reduce but not eliminate public benefits. As a practical matter, housing is often difficult to obtain without a distribution from the special needs trust. In Minnesota, a distribution from a trust that “reduces” public benefits is prohibited.<sup>30</sup>
- *Precatory Language* - Some practitioners use a fully discretionary standard of distribution with precatory language urging the trustee to exercise discretion to make distributions on behalf of the beneficiary for supplemental needs. State law must be consulted, particularly in Ohio.<sup>31</sup>
- *Spigot Trusts* - The last distribution standard is a spigot trust. A spigot distribution standard is fully discretionary, but expressly gives the trustee authority to reduce public benefits. Such a standard is explicitly authorized in New York.<sup>32</sup> Such trusts are also recognized in New York and New Jersey in the regional POMS.<sup>33</sup>

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<sup>28</sup> *Lange v. Commonwealth of Pa. Dept. of Public Welfare*, 515 Pa. 428, 528 A.2d 1335 (1987); *Snyder v. Commonwealth of Pa. Dept. of Public Welfare*, 528 Pa. 491, 598 A.2d 1283 (1991); *Commonwealth Bank and Trust Company v. Commonwealth of Pa. Dept. of Public Welfare*, 528 Pa. 482, 598 A.2d 1279 (1991); *Rosenberg v. Commonwealth of Pa. Dept. of Public Welfare*, 545 Pa. 27, 689 A.2d 767 (1996); *Shaak v. Pa. Dept. of Public Welfare* (Pa. Sup. Ct., No. 0032MD Appeal Docket 1999 (3/27/00)).

<sup>29</sup> Ohio Rev. Code § 1339.51(D)(4); *In Re Will of Cooper*, 76 Misc. 2d 166, 349 N.Y.S.2d 613 (Surr. Ct., 1973); *Zeoli v. Comm’r of Social Servs.*, 179 Conn. 83, 425 A.2d 553 (1979).

<sup>30</sup> Minn. Stat. 501B.89, 2(d).

<sup>31</sup> *Id.*

<sup>32</sup> N.Y. EPTL 7.1.12(e)(2)(i)(5).

<sup>33</sup> POMS SI NY 01120.200(A)(4).

## **2. Periodic payments**

If the beneficiary has a right to mandatory periodic payments from the trust, the trust assets may be a resource to the individual. The value would be the present value of the anticipated string of payments unless a spend-thrift clause or other language prohibits the anticipation of such payments.

## **3. Cristofani powers**

Crummey powers present a special problem with respect to a special needs trust because, as a general rule, the Crummey provision is a noncumulative withdrawal right to the beneficiary. If the disabled beneficiary has a right to withdraw the gift, it is income for SSI purposes. To avoid this result, draft with Cristofani powers, which give the contingent beneficiaries the right of withdrawal.

## **B. SSI/Medicaid Transfer Rules**

The second key in drafting trusts is whether or not the funding of the trust constitutes a transfer subject to the transfer penalty rules of SSI and/or Medicaid.

### **1. Third party special needs trust**

- *Revocable.* If the third party special needs trust is an inter vivos revocable trust, then the assets are still available to the grantor so no transfer has taken place. A transfer will be considered to have taken place on the date of the payment from the trust to the beneficiary.
- *Irrevocable Inter Vivos Trust.* If a transfer is made to an irrevocable inter vivos third party special needs trust during the lifetime of the grantor, the transfer is subject to the SSI and Medicaid transfer rules.
- *Irrevocable Testamentary Third Party Special Needs Trust.* A trust is defined as including any legal instrument or device that is similar to a trust,

but not including testamentary trusts.<sup>34</sup> Therefore, testamentary transfers to a third party special needs trust are not subject to SSI or Medicaid transfer rules. There are no transfer penalties for a transfer to a self-settled special needs trust, because such transfers are exempt.<sup>35</sup>

## **2. Self-settled special needs trust**

There is no transfer penalty for transfer to a self-settled special needs trust, because such transfers are exempt by statute.<sup>36</sup>

### **C. Payback**

The Medicaid payback provisions are a creature of statute. They were established in OBRA '93. They apply only to miller trusts,<sup>37</sup> pooled trusts,<sup>38</sup> and under 65 disability trusts or self-settled special needs trusts.<sup>39</sup> The Health Care Financing Administration (HCFA) has clarified and confirmed this interpretation in a letter dated January 19, 2001, to Raymon B. Harvey.<sup>40</sup>

There is no payback requirement to the state Medicaid agency from third party special needs trusts. Those trusts may provide that upon the death of the disabled beneficiary assets are distributed to remaindermen. In a self-settled special needs trust a payback provisions is required by statute.

There appears to be no restriction in federal law on naming a family member as contingent beneficiary of the guaranteed portion or a structure upon the death of the primary beneficiary of a structure, however, state law must be consulted. The Supreme Court of New York held that there is no authority to consider any guaranteed payment remaining after the death of the trust beneficiary from the trust assets subject to the State's remainder interest.<sup>41</sup> This would have the effect of avoiding a payback to Medicaid since the structure would then be paid to the family member and

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<sup>34</sup> 42 U.S.C. § 1396p(d)(6); HCFA Transmittal 64 § 3259.1A1.

<sup>35</sup> 42 U.S.C. § 1396p(d)(4)(A).

<sup>36</sup> 42 U.S.C. § 1396p(d)(4)(A).

<sup>37</sup> 42 U.S.C. § 1396p(d)(4)(B).

<sup>38</sup> 42 U.S.C. § 1396p(d)(4)(C).

<sup>39</sup> 42 U.S.C. § 1396p(d)(4)(A).

<sup>40</sup> Thomas D. Begley, Jr. & Jo-Anne Herina Jeffreys, *Representing the Elderly Client*, Law & Practice, Aspen Publishers Inc., Appendix 8A.

<sup>41</sup> IMO Eddie Sanango, Supreme Court of New York, County of Kings, Index No. 41383/94 (Oct. 22, 2002).

not to the trust. Only assets remaining in the trust would be required to be paid to Medicaid. The guaranteed portion of the future payment would be includable in the estate of the deceased beneficiary. Consideration should be given to purchasing a commutation rider from the insurance company to provide for funds to pay the federal estate tax.

Prior to a distribution to residual beneficiaries Medicaid must be repaid for all funds expended on behalf of the deceased Medicaid recipient. If more than one state has made payments and the funds remaining in the trust are insufficient to repay all of the states, then payment is made on a pro rata basis.

A California case carved out an exception to the payback provisions where the sole beneficiary of the trust on the death of the primary beneficiary is a disabled child.<sup>42</sup> In the Arnold case a self-settled special needs trust was established for the benefit of Etoria Hatcher. It was funded with \$450,000 from the proceeds of a settlement of a lawsuit. The trust provided that upon death the remaining principal and income was to be distributed to Brenda Arnold, the daughter of Etoria Hatcher. Brenda Arnold was disabled. The court held that Congress intended that there be an interplay between the estate recovery rules and the payback provisions in self-settled special needs trusts. The court held that the provisions of 42 U.S.C. § 1396p(d)(4)(A) apply only to Medicaid eligibility and that federal estate recovery law expressly excludes assets distributed to an adult disabled child.

## **V. THIRD PARTY SPECIAL NEEDS TRUSTS**

### **A. Estate Planning Options**

Parents of disabled children have four options with respect to estate planning: (1) disinherit the disabled child; (2) distribute the assets to the disabled child; (3) distribute assets to siblings with the understanding that the siblings will use the assets for the benefit of the disabled child; or (4) distribute assets to a special needs trust.

### **B. Disinherit Disabled Child**

The first estate planning option is to simply disinherit the child. If the parent's estate is relatively modest and the child's needs are great, this may be the best approach, because any legacy from a modest estate would be inadequate to meet significant needs of a child.

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<sup>42</sup> Bonta v. Arnold, 2004 W.L. 2952765 (Cal. App. 2 Dist.) (Dec. 22, 2004).

### **C. Gift To Disabled Child**

The second option is to make the gift to the disabled child. The problem with distribution assets to the disabled child is the impact it has on government benefits that are means tested. Benefits may be reduced or eliminated. This may render the disabled child ineligible for SSI, Medicaid, or federally assisted housing, as well as for supported employment and vocational rehabilitation services, group housing, job coaches, personal attendant care, and transportation assistance. In addition, the child may be charged for program benefits previously received. While the monthly payment received from SSI is often important, Medicaid is crucial since it represents the child's medical insurance. For example, patients in public mental institutions are charged for their care. If a child inherits a substantial sum of money, the state will charge the resident for the cost of care, and will continue to charge until all of the monies have been exhausted. The state may even back-charge for care previously provided. The care will, usually, be the same whether paid for privately or by government programs. Use of a properly drafted trust avoids virtual confiscation of the funds by public institutions.

### **D. Distribution To Sibling**

The third option is to distribute the assets to a sibling with the understanding that the sibling will use the monies for the benefit of the disabled child. Distribution to other children is a risky proposition. If assets are distributed to siblings, the asset are held in the name of the sibling. They are then exposed to creditors of the sibling. The assets may also be claimed in a divorce action by the sibling's spouse. In addition, these is also the risk of misappropriation or mismanagement by the sibling. Also, if the sibling spends more than \$12,000 per year of the inheritance for the benefit of the disabled person, a taxable gift may result.

### **E. Special Needs Trust**

The final option is distribution to a special needs trust. The primary purpose of the special needs trust is to benefit individuals who qualify for public assistance programs that are means-tested. In addition, since the disabled child is often unable to manage his or her financial affairs, by establishing a special needs trust the parent ensures proper management by a qualified trustee. A special needs trust is designed so that the funds are not considered "available" to the beneficiary. A special needs trust must be a discretionary spendthrift trust that limits the discretion of the trustee. No distribution of principal and/or income may be made that would reduce

the amount of public benefits to which the beneficiary would otherwise be entitled. The beneficiary cannot compel distribution.

#### **F. Testamentary Or Inter Vivos**

As a general rule, it is preferable to have the special needs trust established as an inter vivos trust. The advantage of an inter vivos trust is that if other family members want to provide for the disabled person, they may do so through the already existing special needs trust. Another advantage is that if an individual is to serve as successor trustee, that individual can gain some experience acting as a co-trustee during the grantor's lifetime. This experience is gained under the watchful eye and direction of the grantor and will be valuable to the successor trustee on the death of the grantor. An inter vivos trust can be a standby trust that remains unfunded until the death of the grantor, if that is what the grantor intends. The will of the grantor simply would pour all or a part of the grantor's assets into the trust.

#### **G. Revocable Or Irrevocable**

Whether an inter vivos special needs trust is revocable or irrevocable is often determined by the tax objectives of the settlor. If the grantor wants to maintain maximum control over trust assets and is not concerned about federal estate and gift taxes, the trust can be revocable until the death of the grantor or until it is funded by assets gifted by a third party such as a grandparent or aunt or uncle. Keeping the special needs trust revocable allows grandparents to make gifts into the special needs trust that qualify for the gift tax annual exclusion as gifts to the grantor without need for Crummey provisions in the trust instrument.<sup>43</sup> It also obviates the need to file fiduciary income tax returns, so long as the trust is revocable. If the grantor intends to utilize the trust to save estate or gift taxes, he might establish the trust as irrevocable from the outset.

### **VI. SELF-SETTLED SPECIAL NEEDS TRUSTS**

#### **A. Introduction**

When an injured party receives money as a result of a tort action, the settlement or award may jeopardize his or her public benefits. The same result may occur if a disabled person receives an equitable distribution in settlement of a matrimonial action or if a disabled person receives an

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<sup>43</sup> Crummey provisions give the trust beneficiary the right to withdraw money from the trust. The gift made in trust then qualifies as "present interest" qualifying for the annual gift exclusion. *Crummey v. Commissioner*, 397 F.2d 82 (9<sup>th</sup> Cir. 1968); Rev. Rul. 80-261, 1980 C.B. 79.

inheritance. Alimony payments are assignable income and should be able to be paid into a special needs trust to preserve eligibility for public benefits. Similarly, receipt of proceeds of a settlement may cause a person to lose his or her public benefits. In 1993 as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) Congress created a safe harbor for the use of special needs trusts in these situations.<sup>44</sup> These trusts are commonly referred to as (d)(4)(A) trusts. While this section will focus on the use of such trusts in a tort claim setting, they can be used in any situation in which the settlor is establishing a trust with his or her own funds. Types of situations in which self-settled special needs trusts are used include:

- Tort recovery
- Inheritance
- Equitable distribution
- Alimony

Recently enacted provisions of the Foster Care Independence Act of 1999<sup>45</sup> apply to self-settled special needs trusts. They do not apply to third-party special needs trusts. If the assets of the individual are used to establish the trust, it is considered a self-settled trust.<sup>46</sup>

If the trust is revocable, it is considered an available resource.<sup>47</sup> If the trust is irrevocable, it is considered an available resource to the extent that payments from the trust could be made to or for the benefit of the grantor or the grantor's spouse.<sup>48</sup> However, these provisions do not apply to (d)(4)(A) trusts.<sup>49</sup>

## **B. Statutory Drafting Issues**

### **1. Assets of the individual**

The trust must be funded with *assets of the individual*. Even if the document names a different grantor, if the assets directed to the trust are those of the beneficiary, it is a self-settled special needs trust.<sup>50</sup> Assets recovered in a tort action are considered to be assets of the individual. In some states, such as Arizona, this is

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<sup>44</sup> 42 U.S.C. § 1396p(d)(4)(A)

<sup>45</sup> H.R. 3443 Foster Care Independence Act of 1999 § 205.

<sup>46</sup> *Id.* at § 205(e)(2)(A).

<sup>47</sup> *Id.* at § 205(e)(3)(A).

<sup>48</sup> *Id.* at § 205(e)(3)(B).

<sup>49</sup> 42 U.S.C. § 1396(p)(d)(4)(A).

<sup>50</sup> POMS SI 01120.200.B.7

interpreted to mean that the trust must be funded *exclusively* with assets of the individual rather than assets of the parent or grandparent as well as assets of the individual. Assets that the beneficiary received through inheritance or equitable distribution are also considered assets of the individual for this purpose. Technically alimony and child support are income and not assets, but it is likely that they would be considered assets of the individual for purposes of establishing a self-settled special needs trust.

For purposes of determining Veterans pension benefits, the assets in a self-settled special needs trust must be considered in determining eligibility for a VA pension.<sup>51</sup>

## **2. Under 65 years of age**

A so-called (d)(4)(A) trust (i.e., a self-settled special needs trust) can be established only for a person *under 65 years of age*. This means that the trust document must be in place and funded prior to the beneficiary's attaining his or her 65th birthday. The Centers for Medicare & Medicaid Services ("CMS") has indicated that the trust can continue after the beneficiary attains the age of 65.<sup>52</sup> However, additions to the trust cannot be made after the beneficiary reaches age 65. In the case of a structured settlement annuity in place prior to the beneficiary's attaining age 65, payment can continue to be made from the structure to the trust after the beneficiary reaches age 65. The Social Security Administration considers the structure itself to be "old money" and permits old money to earn "new money."

Persons over age 65 may avail themselves of the use of a pooled trust established by a non-profit association.<sup>53</sup>

## **3. Disabled**

The beneficiary of the trust must be *disabled* as defined in the Social Security Act.<sup>54</sup> The definition of disability for (d)(4)(A) trusts is the same definition contained in the Social Security Act

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<sup>51</sup> Department of Veterans Affairs, Office of the General Counsel, Washington, D.C., VAO Pg. Cp. Rec. 33-97.

<sup>52</sup> Letter from Sally K. Richardson, Director of the Medicaid Bureau of the Health Care Financing Administration, to James C. Corman, dated November 23, 1993.

<sup>53</sup> 42 U.S.C. § 1396p(d)(4)(C).

<sup>54</sup> 42 U.S.C. § 1382c(a)3A

which is applied for determining eligibility for SSI or SSD. The Social Security Act provides “an 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 that 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.)<sup>55</sup>

Lawyers are frequently called upon to draft a special needs trust before the beneficiary has been determined to be disabled by the Social Security Administration. David Lillesand, an elder law/disability law attorney in Florida, suggests that lawyers obtain an advisory opinion or opinion letter from an experienced Social Security disability attorney as the foundation to proceed in drafting the special needs trust when the SSA disability determination has not yet been made.<sup>56</sup> The Program Operations Manual System (“POMS”) provides that if there has not been a determination of disability, the case can be sent for a medical determination after the trust has been established.<sup>57</sup>

#### **4. For the benefit of such individual**

The trust must be established *for the benefit of such individual*. In some states, such as New Jersey, this has been interpreted to mean that the trust must be for the “sole benefit of” the disabled person.<sup>58</sup> In New York, special needs trusts must be for the “primary benefit of” the disabled individual.<sup>59</sup> The trust may provide for payment of reasonable compensation for trustees to manage the trust, as well as “reasonable costs associated with investment, legal or other services rendered on behalf of the individual.” Such payments do not violate the “sole benefit of” requirements.

The concept of “sole benefit of” leads to the concept of “*pro rata share*.” If the assets of a self-settled special needs trust need to be

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<sup>55</sup> 42 U.S.C. § 1382c(a)3A

<sup>56</sup> SSI Analysis of Special Needs Trusts Using the POMS, by David J. Lillesand, Esq., Special Needs Trusts IV, Stetson University, Oct. 18, 2002.

<sup>57</sup> POMS SI 01150.121

<sup>58</sup> N.J.A.C. 10:71-4.11(g)

<sup>59</sup> New York State Department of Social Services, Transmittal 96 ADM-8 IV A 7 b ii

used for the sole benefit of the beneficiary, those persons receiving incidental benefits must contribute their pro rata share. For example, if there is a family of four consisting of two parents, one healthy child and one disabled child and the trust purchases a home, then the parents and healthy child must pay their pro rata share of all expenses relating to the home. Otherwise, the use of trust funds would not have been for the “sole benefit of” the disabled person.

A related issue is whether trust distributions can be made to discharge a “*legal obligation of support*” of a parent. Many states, such as New Jersey, by regulation prohibit the use of trust funds to discharge a legal obligation of support unless the parents are unable to satisfy the legal obligation of support from their own funds.

## **5. Established by**

The trust can be *established* only by a parent, grandparent, legal guardian of the individual, or a court.

### **a. Parent or grandparent**

An issue has arisen as to whether a *parent* or *grandparent* is authorized to establish a trust since the monies used to fund the trust belong to the beneficiary. In some parts of the country, the Social Security Administration recognizes the authority of a parent or grandparent to establish an empty trust or a seed trust for the purpose of receiving a competent adult SSI beneficiary’s assets at a later time.<sup>60</sup>

Unfortunately, this leaves an issue in other states and also an issue when the beneficiary is a minor or an incompetent adult. There are two solutions to this problem. If the beneficiary is a competent adult, he can execute a power of attorney authorizing the parent or grandparent to establish the trust. If the beneficiary is not a competent adult, then Andy Hook’s \$10 solution must be used.<sup>61</sup> Under this solution, the parent or grandparent establishes the trust and

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<sup>60</sup> Regional Counsel’s Opinion Letter, Region III, dated August 27, 2003. Region III includes Delaware, the District of Columbia, Virginia, Maryland, Pennsylvania and West Virginia.

<sup>61</sup> See Hook and Begley, Jr., “Elder Law: When is an Irrevocable Special Needs Trust Considered to be Revocable?,” 31 ETPL 205 (Apr. 2004).

deposits \$10 of the parent's or grandparent's funds into the trust. State law must be consulted to determine if the funds of a third party may be deposited in a self-settled special needs trust. The parent or grandparent then has authority because that person is using his or her own money to establish the trust.

Whether or not a parent or grandparent can establish a seed trust is a matter of state law and also a potential issue with respect to the regional POMS. The POMS for Region III<sup>62</sup> concluded that where a parent or grandparent establishes an empty trust or seed trust for purposes of receiving a competent SSI beneficiary's assets at a later date, the trust will be recognized as valid in all states in Region III. These states include: Virginia, Delaware, Maryland, Pennsylvania, and West Virginia.

#### **b. Guardian**

A *guardian* can obtain a court order authorizing the guardian to establish the trust.<sup>63</sup> If the trust is established by the parent of a minor child, no power of attorney or other legal authority is required, because the parent is the natural guardian of the child.

As to the issue of whether a guardian can establish a self-settled special needs trust on behalf of the ward, a Wisconsin appellate court has ruled that the Wisconsin guardianship statute permits the transfer of guardianship assets to a d4A trust or Medicaid payback trust for the benefit of the Ward.<sup>64</sup>

A court can also refuse to establish a self-settled special needs trust if it is held that the trust would not be appropriate. In this case the trial court held that there were procedural and drafting problems pertaining to the trust and declined to establish the trust. The state appellate court upheld the decision of the trial court.<sup>65</sup>

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<sup>62</sup> PS 01825.009 Delaware, Aug. 27, 2003

<sup>63</sup> In the Matter of the Guardianship of Scott G.G., No. 02-1121 (Wis. App. Feb. 2, 2003)

<sup>64</sup> *Id.*

<sup>65</sup> Mental Hygiene Legal Services *Exrel.* Thomas C. v. Bishop, 748 NYS 2.d 617, 298 A.D. 2d 644 (App. Div. 2002).

### **c. Court**

Having the trust established by the *court* does not necessarily mean the court must sign the document. In fact, many judges are reluctant to do so. The trust can be drafted and refer to the establishment of the trust by court order incorporating the trust by reference. The Social Security Administration will recognize trusts established in this manner.

If a disabled person is a minor or mentally incompetent, court supervision of a settlement is usually required. In cases where counsel wants a court to establish a trust but court supervision is not required, a complaint can be filed and the settlement put on the record so the parties can reach a compromise.

### **6. Payback**

The trust must contain a *payback* provision providing that the State Medicaid Agency will receive all amounts remaining in the trust upon the death of the beneficiary up to an amount equal to the total medical assistance paid. The trust must contain specific language to that effect.<sup>66</sup> Reimbursement must be up to an amount equal to the total medical assistance paid on behalf of the individual. If more than one state paid for medical assistance for the beneficiary then all states must be reimbursed, and if the funds remaining in the trust are insufficient, the reimbursement is *pro rata* among the states.

The trust could contain the following expenses that can be deducted prior to pay back to the State Medicaid Agency:<sup>67</sup>

- Taxes due from the trust to the state or federal government because of the death of the beneficiary
- Reasonable fees for administration of the trust estate, such as an accounting of the trust of a court, completion and filing of documents, or other required actions associated with termination and wrapping up of the trust.

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<sup>66</sup> POMS SI 01120.203.B.1.f

<sup>67</sup> POMS § S.I. 01120.203B.3.

Payment of the following expenses are not permitted prior to reimbursement of the State Medicaid Agency:

- Payment of debts owed to third parties
- Funeral expenses
- Payments to residual beneficiaries

David Lillesand, an SSI and elder law attorney in Miami, Florida, has labeled the prohibition against trust payment of funeral expenses as the “stinking dead body rule.”

## C. Non-Statutory Drafting Issues

### 1. Revocability

Not only must the practitioner comply with Medicaid law, but the Social Security POMS must also be considered when drafting a special needs trust.<sup>68</sup> The main consideration when drafting a special needs trust is whether or not the trust is irrevocable. SSA rules have always provided that the principal of a trust is not an available resource if the beneficiary has no power to revoke the trust and use the principal for his or her own support or maintenance.<sup>69</sup> The POMS state: “Revocability of a trust depends on the terms of the trust agreement and/or on state law. If a trust is irrevocable, the trust principal is not a resource.”<sup>70</sup> Therefore, the issue is really one of availability. As a general rule of trust law, a trust can be revoked with the mutual consent of the settlor and all of the beneficiaries. SSA reasons that if the same person is the beneficiary and the grantor, he can independently revoke the trust. Therefore, the funds in the trust would be “available.”

The POMS also states: “If an individual (claimant, recipient, or deemor) has legal authority to revoke the trust and then use the funds to meet his food, clothing 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.”<sup>71</sup> In addition, “Even if the power to revoke a trust is not specifically retained, a trust may

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<sup>68</sup> See § 12.03 supra for a discussion of the POMS

<sup>69</sup> POMS § S.I. 01120.200.D.2

<sup>70</sup> *Id.*

<sup>71</sup> POMS § S.I. 01120.200.D.1.a

be revocable in certain situations.”<sup>72</sup> The reasoning of SSA is that state law presumes revocability in certain circumstances. Most states follow the general principal that if a grantor is also the sole beneficiary of a trust, the trust is revocable, regardless of language in the trust document to the contrary.<sup>73</sup>

SSA treats an individual as the grantor of the trust if the trust was established with the person's funds, even if the trust was actually established by someone else acting as his or her agent.<sup>74</sup>

The POMS does note that some states recognize the irrevocability of a grantor trust if the trust contains a named residuary beneficiary.<sup>75</sup> It is good practice to name a specific residual beneficiary to prevent the trust from being considered revocable. SSA acknowledges that some states recognize that naming a particular beneficiary to receive the assets in the trust remaining after the Medicaid reimbursement “preserves the irrevocability of a trust.”<sup>76</sup>

It is important to draft trusts to name a specific beneficiary such as issue, or in default of such issue, then to certain other named persons in order to avoid the SSA argument of “revocability,” which leads to “availability.” Another technique to prevent the revocability issues from arising would be to require in the document that court approval be obtained for termination of the trust. An argument could then be made that the settlor/beneficiary did not have the right to terminate the trust and, therefore, it is not revocable.

The author's preference is to have the (d)(4)(A) trust signed by the court. Some courts are reluctant to do this, because they feel they have no authority to do so.<sup>77</sup> If a court refuses to sign the trust, the court should enter an order establishing the trust and incorporate the trust by reference. This latter practice is currently accepted by the Social Security Administration, but is under study. It is possible that in the future SSA may require the judge's signature on the trust document. Good practice is to submit a brief showing

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<sup>72</sup> POMS § S.I. 01120.200.D.1.b

<sup>73</sup> POMS § S.I. 01120.200.D.3

<sup>74</sup> POMS § S.I. 01120.200.B.2

<sup>75</sup> POMS § S.I. 01120.200.B.12

<sup>76</sup> POMS § S.I. 01120.200.D.3

<sup>77</sup> 42 U.S.C. § 2496p(d)(4)(A)

that the Social Security Act specifically grants such authority.<sup>78</sup> In Kansas, a trial court refused to establish a (d)(4)(A) trust to allow a conservator to put the disabled son's estate distribution into the trust, stating that "The federal legislation is nothing more than recognition at best."<sup>79</sup> The Court of Appeals permitted the establishment of the trust finding it contemplated under both federal and state law.<sup>80</sup>

## **2. Notification requirements**

The trust should contain provisions for notification to the appropriate state agency upon the death of the beneficiary. The trust shall also provide for notice to the county agency for any distributions from the trust for less than fair market value. A state Medicaid agency is a creditor of the trust upon the beneficiary's death, but is not a beneficiary of the trust.

## **3. Discretion**

The trustee must have sole and absolute *discretion* over the use of the trust income and corpus. If the beneficiary has a right to compel the trustee to use the money on behalf of the beneficiary, then the trust is not a special needs trust and the money will be considered "available" for public benefit purposes.<sup>81</sup>

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<sup>78</sup> See Form 12-14 *infra* for a sample brief

<sup>79</sup> In the Matter of Watkins, 24 Kan. App. 2d 469, 947 P.2d 45 (Kan. Ct. App. 1997)

<sup>80</sup> *Id.*

<sup>81</sup> Social Security Administration Program Operations Manual System (POMS) § S.I. 01120.200.B.1

#### **4. Third party creditors**

A lawyer drafting a special needs trust must be aware that the assets in the trust are protected from claims of a State Medicaid Agency, but are not protected from claims by *third party creditors*.<sup>82</sup> The restatement (second) of trusts provides that an irrevocable, pure discretionary self-settled trust affords no protection from the settlor's general creditors.<sup>83</sup> The beneficiary's creditors can reach the maximum amount, which the trustee has discretion to pay to the beneficiary. This language has been adopted by the third restatement of trusts. The solution to this problem is to draft a trust in compliance with the law of an asset protection trust state, such as Alaska, Delaware, Rhode Island, Nevada, or Utah.

#### **5. Prepaid funeral**

A special needs trust should provide for purchase of a *prepaid funeral*. A Medicaid payback takes priority over the purchase of a prepaid funeral, so failure to purchase a funeral during the lifetime of the beneficiary may result in insufficient funds being available to purchase the funeral.

#### **6. Termination of disability**

A final issue to be addressed by the scrivener is what happens when the *beneficiary is no longer disabled*. One solution would be for the trust, by its terms, to convert from a special needs trust to a purely discretionary trust authorizing the trustee to distribute income and principal to the beneficiary in such amounts and proportions and at such times as the trustee, in its sole, absolute and unfettered discretion, shall determine.

A problem would be converting the trust back to a special needs trust if the beneficiary relapsed into disability. In many states this would be a “trigger trust.” A solution, which should not be included in a trust, would be to authorize the trustee, upon termination of disability, to make distribution of the principal and accrued income to the beneficiary. Such language may cause the entire trust to be considered “available” since there would be a

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<sup>82</sup> See the Greater Asset Protection Self-Settled Special Needs Trusts (GAPSNT), Robert F. Collins, 2004 NAELA Symposium, May 20-23, Hilton Head, South Carolina

<sup>83</sup> Restatement of the Law, Second, Trusts, § 156

circumstance under which the beneficiary may have access to trust assets.<sup>84</sup>

David Lillesand opines that there is no need to do a conversion when a client chooses to stop receiving benefits or is forced from receiving benefits, for example through marriage. Special needs trusts can continue, but free of worries that a particular distribution may disqualify the already disqualified beneficiary. It is Mr. Lillesand's opinion and the authors concur that it is legal malpractice to terminate a special needs trust and repay Medicaid during the beneficiary's lifetime. The beneficiary may need nursing home, Medicaid, or other expensive medical care covered by Medicaid in the future. The law does not require a repayment to Medicaid until the beneficiary's death. It is counterproductive to exhaust the money in the trust by repaying Medicaid prior to the death of the trust beneficiary.

## **VII. APPROVAL OF TRUST**

### **A. Social Security Administration**

The trust should be submitted to the Social Security Administration for approval. SSI recipients are under a continuing duty to report any changes in their income, resources, living arrangements, or other conditions to SSA.<sup>85</sup> When submitting the trust the following items should be submitted in letter form:<sup>86</sup>

- Client's name and Social Security number
- Receipt of personal injury settlement, inheritance, equitable distribution, or other funds, including copies of:
  - Personal injury closing statement or probate documents showing the date of settlement occurred and the date the trust was funded.
  - The trust agreement.

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<sup>84</sup> HCFA Transmittal 64 § 3259.6 E

<sup>85</sup> 20 C.F.R. § 416.708

<sup>86</sup> 20 C.F.R. § 416.710

- Bank statement showing the deposit to the trustee's account and any disbursements from the account to date.

David Lillesand also suggests including the following:<sup>87</sup>

- SSI spotlight on trust
- SSA POMS section containing the eight steps and action chart to help the CR (claims representative) in analyzing the trust.
- Copy of Medicaid counsel's letter approving the trust, if applicable.

It is also suggested that the trust and supporting documents be submitted by certified mail. The letter would be sent to the local SSA office providing services to the client or to the SSA district office pertaining to the representative payee, if there is a representative payee. The local office can be obtained by the client or through the Social Security office locator at [www.ssa.gov](http://www.ssa.gov) with the client or representative payee's zip code. It is unlikely that SSA will send a letter approving the trust, but they will definitely send a letter if the trust is not approved.

#### **B. Department Of Public Welfare**

The trust should be submitted to the Pennsylvania Department of Public Welfare for approval. Upon approval the trust must then be sent to the Special Needs Trust Depository. Approval by DPW is only required in the case of a self-settled special needs trust.

### **VIII. DRAFTING PROVISIONS**

#### **A. Grantor Trust**

If it is advantageous for the trust income to be taxed to the grantor trust, provisions must be included in the document. These are typically the right to substitute and reacquire assets and/or a limited testamentary power of appointment.

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<sup>87</sup> Social Security Administration Appeals of Adverse Determination of Your (d)(4)(A) Special Needs Trusts—Practical and Procedural Issues, David Lillesand, NAELA Symposium, May 14-18, 2003.

**B. Intention**

The intention to make the trust supplemental to public benefits should be clearly stated in the document.

**C. Special Needs**

The term “special needs” should be clearly defined.

**D. Distribution Standard**

This is the most critical provision in a special needs trust. A continuing source of debate among practitioners is whether distributions should be permitted for in-kind support and maintenance. In-kind support and maintenance essentially means food and shelter.

**E. Examples Of Distributions**

The POMS contains examples of distributions permitted under special needs trusts. It is good practice to either refer to the POMS or list examples or both.

**F. Regular Contact With Beneficiary**

In most situations the grantor wants the trustee or someone under the trustee’s direct control to have regular contact with beneficiary. The frequency of the contact will be determined largely by the disability of the beneficiary. Unless the trustee is a family member, this burden is onerous and a good solution is to have the trustee retain a care manager.

**G. Distributions Upon The Death Of Beneficiary**

This should be spelled out clearly. In a self-settled trust a payback to the State Medicaid Agency is required, but any excess can be distributed to beneficiaries. These should be clearly defined.

**H. Community Trust**

On occasion large trusts will be spent down so that they are impractical to administer. A support trust would typically provide that the trust be terminated and distribution be made to the beneficiary. Such a provision would disqualify the beneficiary from receiving public benefits. Consideration should be given to including authority for the trustee to

terminate the trust and transfer the remaining funds to a community trust. Pennsylvania is blessed with a number of good pooled trusts.

**I. Successor Trustee**

Provision should always be made for a successor trustee, language should be included authorizing the trustee to resign, and authorizing someone other than a court to appoint a successor trustee if a vacancy occurs in that office.

**J. Compensation**

The compensation of the trustee should be addressed.

**K. Powers Of Trustee**

The trustee's powers should be clearly defined. One power would be to acquire residential real estate and vehicles, although these assets may be considered "wasting assets" and violate normal fiduciary obligations.

**L. Amendment Provisions**

Although a special needs trust once funded must be irrevocable, circumstances do occur that will require amendment. The scrivener should give the trustee the right to amend the trust to comply with changes in federal and state law or to amend the trust to comply with the law of the jurisdiction if the beneficiary changes residence.

**M. Life Insurance**

Life insurance is an ideal asset with which to fund a special needs trust. An irrevocable life insurance trust can be wrapped in a special needs trust for that purpose.

**N. Trust Protector**

If a trust protector is utilized language pertaining to appointment, resignation, compensation, etc. must be included.

## **O. Trust Advisory Committee**

A viable alternative to a trust protector is usually a trust advisory committee to advise the trustee with respect to distributions. In the case a trust advisory committee is appointed, the following issues needs to be addressed:

- Composition
- Resignation
- Meetings
- Distribution requests
- Application for public assistance
- Limited liability
- Compensation

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