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# Special Needs Trusts:

## A Planning Tool with Promise

by Ruthann P. Lacey

**W**ith one in every 26 American families reporting raising a child with a disability,<sup>1</sup> interest in and demand for special needs trusts is on the rise. The prospective client may be a child or an adult with a lifelong disability or someone newly eligible, because of an accident or illness, for insurance-based programs such as Social Security Disability Insurance (SSDI) and Medicare benefits, as well as needs-based programs such as Supplemental Security Income (SSI) and Medicaid.

While there is not a financial component to gaining eligibility for insurance-based programs, financial criteria are a significant part of the eligibility determination for needs-based programs. As public benefit eligibility law becomes more complicated, it should come as no surprise that legal planning tools are evolving to enable children and adults with disabilities to more easily become eligible for these public benefits while also providing for at least partial reimbursement to the



government for some of these public benefits. Special needs trusts (SNTs, also sometimes known as supplemental needs trusts) are among the legal planning tools that fill this need.

## SSI Eligibility Criteria

SSI is a federal welfare program established under Title XVI of the Social Security Act<sup>2</sup> to provide cash assistance to financially needy individuals who are age 65 or older, or blind or disabled,<sup>3</sup> to assure such individuals a minimum level of income (\$674 per month in 2010).

An individual is considered financially needy if he has “countable assets” of no more than \$2,000 (or \$3,000 for a married couple),<sup>4</sup> and has limited income. Assets that are not considered when determining this valuation include: the individual’s home place, limited household goods, an automobile, burial spaces and certain life insurance or up to \$1,500 designated for funeral expenses.<sup>5</sup>

The Social Security Administration defines income as “anything you receive in cash or in kind that you can use to meet your needs for food and shelter.”<sup>6</sup> This includes gifts, inheritances,<sup>7</sup> in-kind assistance, earned and unearned cash and non-cash income and funds received in settlement of a lawsuit or other windfall. To be eligible for SSI benefits in 2010, an individual’s countable monthly income cannot exceed \$674 (or \$1,011 for a couple).<sup>8</sup> However, because many kinds of income are not counted in determining SSI eligibility, an individual may be eligible for SSI even though his income is somewhat higher.

## Medicaid Eligibility Criteria

Medicaid is a joint program between the state and federal governments that pays for necessary health care expenses of eligible individuals.<sup>9</sup> In Georgia, as in many states, eligibility for SSI automatically entitles the SSI recipient to Medicaid eligibility and coverage.<sup>10</sup> In fact, in many situations it is the Medicaid benefit that is most valuable to the SSI recipient.

While Congress establishes the Medicaid eligibility criteria, each state applies that criteria as it sees fit. There are a number of different Medicaid programs in Georgia, and each program has specific financial eligibility criteria. The general criteria is that one must be aged, blind or disabled,<sup>11</sup> have no more than \$2,000 in countable resources and may retain exempt resources including the home place, an automobile, certain life insurance, burial spaces and limited funds designated for funeral expenses.<sup>12</sup>

## Why Plan to Maintain Public Benefits Eligibility?

When a child or adult who is presently eligible for SSI or Medicaid benefits receives an inheritance, personal injury settlement or other windfall, these

resources will be considered by SSI and Medicaid to be “countable resources.”<sup>13</sup> If the value exceeds the \$2,000 resource limit, the individual will be ineligible for further benefits. Prudent planning to prolong the benefit of these funds may be appropriate when the individual has needs beyond essential medical care, such that it would be to his benefit to preserve these resources to purchase goods and services not covered by Medicaid.

The objective, however, is not to preserve the funds indefinitely while the individual with a disability relies on public benefits to pay for living and medical expenses. Rather, good planning allows such excess assets to be invested to generate income and then be spent carefully over a longer period of time—ideally for the individual’s lifetime—for the full and sole benefit of the individual. If proper planning is not done and SSI and Medicaid benefits are lost, the funds may be spent very quickly for medical care and living expenses and the person will be returned to poverty status before he again becomes eligible for benefits.

## Transfer Rules

So, what can legally be done with the excess assets? There are several options. They can be spent to purchase exempt resources that will benefit the individual, or they might be gifted to another individual with the expectation that the recipient will hold the assets for the benefit of the donor. However, if a gift is made, then both SSI and Medicaid rules impose a transfer penalty upon the donor. A penalty is a period of time during which the donor cannot become eligible for SSI or Medicaid benefits *because* he made this gift.

For SSI purposes,<sup>14</sup> a transfer made after Dec. 13, 1999, will result in an ineligibility penalty period of up to three years.<sup>15</sup> This ineligibility period is determined by dividing the total value of the gifts by the maximum monthly SSI benefit effective on the date of application,<sup>16</sup> but the maximum penalty period is 36 months from the date of the transfer.<sup>17</sup>

The Medicaid rules, as of Feb. 8, 2006, provide for a five-year look-back, meaning that any transfer made in the five-year window prior to filing an application for Medicaid benefits will be penalized and result in a period of ineligibility for the applicant. A transfer to an individual or a trust may result in a penalty period of as much as 60 months,<sup>18</sup> which can be extended if a Medicaid application is filed before the penalty period has elapsed.<sup>19</sup> Thus, if an individual makes a gift of his windfall, he will become ineligible for SSI and Medicaid benefits for a time, during which it will be necessary for him to pay for all of his living and medical expenses from his own funds.

## Special Needs Trusts: Exception to the Transfer Rules

Special needs trusts are an important exception to the

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transfer rules.<sup>20</sup> A special needs trust is a discretionary spendthrift trust created for a beneficiary with a disability which supplements but does not supplant public benefits for which the beneficiary may be eligible.<sup>21</sup> It must be carefully drafted to conform with statutory and regulatory requirements to assure the ongoing SSI and Medicaid eligibility of the person with a disability. The SSI and Medicaid rules regarding SNTs are similar though not identical.

Certain SNTs, which are specifically authorized by federal and state law for use by individuals who receive a windfall and presently are, or expect to become, eligible for SSI or Medicaid benefits, are the Individual Self-Settled Special Needs Trust and the Pooled Special Needs Trust. In addition, the Pooled Special Needs Trust and the Third Party Settled Special Needs Trust are useful advance planning tools when the planning is oriented toward using third party assets to supplement public benefits.

### Individual Self-Settled Special Needs Trusts

An irrevocable SNT funded with assets belonging to the beneficiary is a self-settled SNT. A self-settled SNT can be created with proceeds from the settlement of a lawsuit (often times the lawsuit that was initiated to recover for injuries that caused the disability for which the individual now must pursue eligibility for benefits), or with the proceeds of an inheritance that was left outright to the individual. The trust can be funded with one lump sum or over time with a structured settlement, after existing Medicaid, Medicare and private insurance liens have been negotiated and paid.<sup>22</sup>

A SNT created under 42 U.S.C. § 1396p (d)(4)(A) (commonly called a “d4A trust”) must be “established” by a parent, grandparent, legal guardian or court for a beneficiary with a disability who is under age 65, and must be irrevocable.<sup>23</sup> It can continue in effect after the beneficiary becomes 65, but assets cannot be added to it after that time unless they are part of a structured settlement.

For both SSI and Medicaid purposes, the trust document must state that the trust is “for the sole benefit” of the beneficiary,<sup>24</sup> and must provide for Medicaid (but not SSI) to be reimbursed at the death of the beneficiary for the medical care provided during his lifetime.<sup>25</sup> Remainder beneficiaries can be named to receive those residual assets not needed to reimburse Medicaid.<sup>26</sup>

Some see the requirement that Medicaid be reimbursed as a potential downside to a d4A trust. However, because Medicaid pays less for health services than the beneficiary would pay in the open market, the expense is not as large as it would have been had trust assets instead been spent to provide medical care during the beneficiary’s lifetime. Further, this is an equitable way to provide for the beneficiary during his lifetime while alleviating some of the burden on the state’s Medicaid programs.

Although the statute is silent as to provisions for distributions to or for the beneficiary, such trusts usually require that such distributions either be entirely discretionary with the trustee, or be limited to distributions that will “supplement and not supplant”<sup>27</sup> public benefits. Another option is to provide for absolute discretion by the trustee, with a statement of intent that the distributions be used to “supple-

ment and not supplant” public benefits.<sup>28</sup> To avoid ambiguity, yet another possibility is to provide expressly that the trustee may make distributions that disqualify the beneficiary for benefits, if the trustee in its discretion determines that to do so is in the beneficiary’s best interests.

### Pooled Special Needs Trusts

An irrevocable pooled SNT account (commonly called a “d4C trust”) can be established for a beneficiary who is under age 65 by the individual (if he is a competent adult), a parent, grandparent, legal guardian or a court.<sup>29</sup> In Georgia, a pooled SNT can be created through the Georgia Community Trust.<sup>30</sup>

The pooled SNT can be a self-settled trust (if funded with assets belonging to the beneficiary), or a third party trust (if funded with third party funds). It is managed by a non-profit association such as the Georgia Community Trust (GCT),<sup>31</sup> the first pooled trust entity based in Georgia, where each sub-account is tracked separately while the funds are pooled for investment purposes. The assets in the trust can be used to supplement the public benefits the beneficiary receives.

If the funds transferred to the trust belonged to a third party, then the funds remaining after the death of the beneficiary will be distributed to the beneficiaries designated in a joinder agreement. If the funds were transferred by the beneficiary to the trust, the remaining balance must first be used to reimburse the state for Medicaid payments made on behalf of the beneficiary; the remainder can then be distributed via the joinder agreement or be retained by the trust for the benefit of indigent individuals

with a disability. In that event, there is no requirement to reimburse the state.<sup>32</sup>

Among the benefits of a pooled SNT is the fact that a person with a disability can establish his own account. Further, the GCT already exists, so there are no lengthy documents to draft; completing a jointer agreement is all that is required to open an account and the costs are nominal for professional management and trustee services. A pooled account trust is often a good option when the size of the trust estate is insufficient to make it economically feasible to engage a corporate trustee for purposes of managing the trust estate.

### Third Party Settled Special Needs Trusts

Third Party Settled Special Needs Trusts are those to which assets are contributed by someone *other than* the beneficiary.<sup>33</sup> Typically they are created by family members of persons with disabilities, naming the person with a disability as the beneficiary. They may be created by transfers during life (inter vivos trusts)<sup>34</sup> or in a Last Will and Testament document (testamentary trusts).<sup>35</sup> As long as the beneficiary does not have the legal authority to revoke the trust or direct the use of the trust assets for his or her own support and maintenance, the trust principal is not considered to be the beneficiary's resource for SSI and Medicaid purposes.<sup>36</sup>

The benefit to planning with a Third Party SNT is obvious: because the funds do not belong to the beneficiary these SNTs need not have provisions for repaying Medicaid benefits after the beneficiary's death, and they are not affected by the age restrictions on self-settled trusts discussed above. As such, it is not generally wise to commingle estate planning (third party) SNT funds with the beneficiary's (self-settled) SNT funds as discussed above. The option of establishing such a trust should be seriously considered in any estate plan involving

a disabled beneficiary.

For example, a third party SNT can be a particularly attractive option when planning for a family member who has a known disability such as Alzheimer's disease or schizophrenia and who now or later may be eligible for public benefits. A SNT for the person with a disability created under the will of the grantor will be funded with third party assets.

Failure to properly plan in advance may mean that the only option is to use a d4A trust to "save" an inheritance when the grantor has died and the beneficiary with a disability is entitled to the assets; however, to do so while maintaining SSI and/or Medicaid eligibility requires that the SNT include a payback provision, with the result that Medicaid is the first remainder beneficiary. Further, due to the age restriction, if the beneficiary is 65 years of age or older it would be impossible to establish a self-settled SNT.

### Attorney Liability

Courts have held attorneys liable for malpractice for failing to identify and address issues relating to settling litigation and establishing special needs trusts. It is critical for attorneys to be aware of claims by workers' compensation and health insurers as well as governmental agencies based on subrogation in personal injury actions. An Illinois appellate court ordered to trial an attorney malpractice case in which the plaintiffs alleged that the attorneys who drafted their father's will were aware that two of his children were disabled, and that they were negligent in failing to advise the testator of the possibility of establishing a "special needs" trust for his children which would not impair their eligibility for certain public assistance benefits.<sup>37</sup>


In Texas, a plaintiff settled a personal injury case, but later sued the attorney and guardian ad litem for malpractice alleging that the defendants failed to consult competent

experts concerning a structured settlement and failed to plan to preserve her SSI and Medicaid eligibility. She alleged that a structured settlement with a d4A Special Needs Trust would have protected her personal injury settlement from dissipation, as well as provided tax benefits and protected her SSI and Medicaid benefits. The case was settled by all defendants for a combined sum of \$4.1 million.<sup>38</sup>

In Connecticut, a court held that there was a fiduciary duty on the part of an estate's conservator, and indirectly the fiduciary's lawyer, to protect the settlement of a client with a disability.<sup>39</sup> As a part of the application to compromise and settle the claim, the conservator requested that the net settlement amount be placed in a d4A special needs trust for the ward to preserve his Medicaid eligibility. The state of Connecticut objected. The Supreme Court of Connecticut rejected the attorney general's argument that the conservator should spend down all of the ward's assets and then reapply for Medicaid assistance. The court ruled: "By contrast, with the creation of the trust, [the ward] will retain his Medicaid eligibility and [the conservator] can provide for his supplemental needs from the trust assets, while Medicaid provides for his basic medical care. Therefore, not only is the latter course of action clearly better for [the ward], it may be fairly stated that by failing to follow it, the Probate Court, and [the conservator] could be deemed to be in dereliction of their duties to [the ward]."<sup>40</sup>

### Conclusion

It's been said that a society will be judged by how it treats its weakest members. Congress' authorization of the use of special needs trusts reasonably addresses that inequity. SNTs provide a socially responsible mechanism to enable a beneficiary to become or remain eligible for SSI and Medicaid benefits, while procuring supplemental

benefits that he would not otherwise receive. At the same time, SNTs help remove the pressure off an already overburdened benefits system thereby allowing for the continuation of these benefits to future generations of individuals with disabilities. 



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## Endnotes

1. "Disability and American Families: 2000," US Census Bureau, July 2005 Report.
2. Title XVI of the Social Security Act, 42 U.S.C. §§1381 *et seq.* (2009); 20 CFR § 416.101 *et seq.* (2010); governed by operational guidelines contained in the Social Security Program Operation Manual System (POMS).
3. Disabled is defined as "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 12 months." 42 U.S.C. §1382c (a)(3)(A) (2009).
4. 20 C.F.R. § 416.1205 (2010).
5. 20 C.F.R. § 416.1210 (2010).
6. 20 C.F.R. § 416.1102 (2010).
7. 42 U.S.C. §1382a(a)(2)(D) (2009).
8. C.F.R. § 416.1102 (2010).
9. Title XIX of the Social Security Act, 42 U.S.C. §§1396 *et seq.* (2009).
10. 42 U.S.C. §1396a(a)(10)(A)(i)(II) (2009); Georgia Department of

- Human Services, Medicaid Manual Volume II/MA, MT 29-02/08 § 2111-1.
11. O.C.G.A. § 49-4-81.
  12. O.C.G.A. § 49-4-6(a); Volume II/MA, MT 1-01/02 §§2300 *et seq.*
  13. 20 C.F.R. § 416.1201 (2010).
  14. Foster Care Independence Act of 1999, Pub. L. No. 106-169, December 14, 1999.
  15. 42 U.S.C. §1382b (c)(1)(A)(ii)(I) (2009); 20 C.F.R. § 416.1246 (2010).
  16. 42 U.S.C. §1382b (c)(1)(A)(iv) (2009).
  17. 42 U.S.C. §1382b (c)(1)(A)(iv)(II) (2009).
  18. 42 U.S.C. §1396p (c)(1)(B)(i) (2009); Volume II/MA, MT 39-08/10 §2342-1.
  19. *See generally* Volume II/MA, MT 39-08/10 §2342-6.
  20. 42 U.S.C. §1382b (c)(1)(C)(ii)(IV) (2009); 42 U.S.C. §1396p (d)(4) (2009); POMS § SI 01120.203 B.; SI 01150.121 A.3.
  21. *See* Volume II/MA MT 35-08/09 § 2346-2.
  22. 42 U.S.C. §1396a(a)(25)(A) and (B) (2009); *see generally* Patricia Cricchio v. Joseph A. Pennisi *et al.* and James H. Link v. Town of Smithtown *et al.*, 90 N.Y.2d 296, 683 N.E.2d 301, 660 N.Y.S.2d 679 (1997); O.C.G.A. § 49-4-149(a).
  23. 42 U.S.C. §1382b(c)(1)(C)(ii)(IV) (2009); 42 U.S.C. §1396p(d)(4)(A) (2009) ("A trust containing the assets of an individual under age 65 who is disabled [as defined in §1614(a)(3)] 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 [title]."); POMS § SI 01120.203 B.1.; Volume II/MA, MT 35-08/09 §2346-1.
  24. 42 U.S.C. §1382b(c)(1)(C)(ii)(IV) (2009); 42 U.S.C. §1396p(c)(2)(B) (2009); POMS § SI 01120.201.F.2.
  25. 42 U.S.C. §1396p(d)(4)(A) (2009); POMS § SI 01120.203 B.1.h.; POMS § SI 01120.203 B.2.g.
  26. POMS § SI ATL01120.201.
  27. Volume II/MA, MT 35-08/09 § 2346-2.
  28. *Id.*
  29. 42 U.S.C. §1382b(c)(1)(C)(ii)(IV)

- (2009); 42 U.S.C. §1396p(d)(4)(C) (2009) ("A trust containing the assets of an individual who is disabled [as defined in §1614(a)(3)] 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 the individuals who are disabled [as defined in §1614(a)(3)] 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 [title].").
30. 42 U.S.C. §1382b(c)(1)(C)(ii)(IV) (2009); 42 U.S.C. §1396p(d)(4)(C) (2009); O.C.G.A. §§30-10-1 - 30-10-9; Volume II/MA, MT 39-08/10 §2337-2.
  31. [www.georgiacommunitytrust.com](http://www.georgiacommunitytrust.com).
  32. 42 U.S.C. §1396p(d)(4)(C)(iv) (2009); POMS § SI 01120.203 B.2.g.
  33. POMS § SI 01120.200 B.17.
  34. 42 U.S.C. §1382b(c)(1)(C)(ii)(III) (2009); 42 U.S.C. §1396p(c)(2)(B)(iii) and (iv) (2009).
  35. 42 U.S.C. §1382b(e)(2)(A) (2009); 42 U.S.C. §1396p(d)(2)(A) (2009); Volume II/MA, MT 39-08/10 §2337-1; Volume II/MA, MT 39-08/10 § 2338-2.
  36. POMS § SI 01120.200 D.1.a. and b.; Volume II/MA, MT 37-02/10 §2338-1.
  37. *See* Catherine Rajcan *et al.* v. Donald Garvey & Associates, Ltd. *et al.*, 347 Ill. App. 3d 403, 408, 807 N.E.2d 725, 729, 283 Ill. Dec. 120 (2004).
  38. *See* Josephine Grillo v. Tom Pettiette *et al.*, Cause No. 96-145090-92, 96th Judicial District Court, Tarrant County, Texas.
  39. *Department of Social Services v. Edith A. Saunders*, 247 Conn. 686, 709, 724 A.2d 1093, 1105 (1999).
  40. *Id.*