

Special Needs Trusts

What is a Trust?

A trust is a legal agreement between the “grantor,” who contributed property to the trust, and a “trustee,” who is obligated to manage the property and make distributions to one or more “beneficiaries.” There are several kinds of trusts, including revocable “living trusts,” “testamentary trusts” established under wills, “asset protection trusts,” and “special needs trusts” for disabled beneficiaries. Trusts can be revocable or irrevocable. Trusts have many purposes for estate planning and for planning to protect assets for the use of a disabled beneficiary.

How is a Special Needs Trust “Special”?

A “special needs trust” (SNT) is the type of trust used to protect assets for the benefit of a disabled person in a way that does not disqualify the disabled person from getting public benefits. The assets in the trust are used to improve the quality of life of the disabled beneficiary. The trustee does this by paying for the supplemental needs of the beneficiary that are not paid by SSI or Medicaid (TennCare) or other government benefits.

Sometimes those public benefits are crucial to the health and basic support of the disabled person. If a disabled person needing SSI or Medicaid has more than \$2,000 of investment assets, he would be ineligible for these benefits, or would lose them if he should receive them from someone else. Without Medicaid, the cost of medical care alone would rapidly deplete almost any gift or lawsuit settlement, leaving very little to actually improve the quality of life of the person with disabilities.

Medicaid cut-backs are increasingly limiting the kinds of medical care paid by their programs. The need for special needs trusts will become more and more crucial for the well-being of those with disabilities.

With proper planning, assets placed in a special needs trust can pay for those supplemental needs that Medicaid and SSI will not pay for without causing the beneficiary to be disqualified. The disabled beneficiary can have a more comfortable and secure life because he can continue to receive government benefits and get the benefit of the assets in the special needs trust.

The trustee of the special needs trust has the “discretionary authority” to pay for almost anything that is not provided by government programs like Medicaid and SSI. If the trustee of an SNT does not follow the restrictions of SSI and Medicaid law regarding distributions, however, the

beneficiary can lose those benefits and force the trust assets to be used up paying for medical care or support.

Two Types of Special Needs Trusts

There are two general types of special needs trusts: “third party” special needs trusts, which are established with gifts paid into the trust, and “first party” special needs trusts (also called “first party” or “Medicaid pay-back” trusts). Federal and state laws treat the two types of SNTs very differently, but both types of trusts are treated as being “unavailable resources” for purposes of determining the Medicaid or SSI eligibility of a disabled beneficiary.

“Third Party” Special Needs Trust

A “third party” special needs trust is used to receive gifts from family members or friends for the benefit of a disabled person in a way that does not disqualify the beneficiary from public benefits like SSI and Medicaid. A third party SNT can be revocable, irrevocable, or testamentary (in a Will). They are often called “supplemental needs trusts” to distinguish them from “first party” Medicaid pay-back trusts.

Family members may already assist or support family members who are disabled. For example, an elderly parent may need assistance with care or living expenses, and adult children with intellectual or developmental disabilities may have always lived in their parents’ home. Unfortunately, if the disabled family member needs government benefits like SSI or Medicaid, gifts directly to the family member can actually disqualify the disabled beneficiary from SSI or Medicaid benefits.

If the family members make gifts directly to a supplemental needs trust instead, those government benefits are protected and the trust assets can be available pay for the beneficiary’s supplemental needs.

Third party special needs trusts established by a spouse for the benefit of the other spouse can only be created by Will, as a testamentary SNT. Trusts established during lifetime by a married disabled individual are considered to be “first party” trusts, and can only be established as a Medicaid pay-back trust when the disabled person is under age 65.

Third party supplemental needs trusts have several other important advantages:

- First, the person establishing the trust (the “grantor” or “settlor”) can designate the remainder beneficiaries of the trust. There is no “Medicaid-payback” requirement for a third party SNT.

- Second, unlike a Medicaid-payback SNT, there is no age limit—the disabled beneficiary can be over 65 years of age when the trust is established and funded.
- Third, the trustee’s authority to make distributions is more liberal than with a Medicaid-payback SNT.
- Fourth, unlike Medicaid-payback trusts, there can be multiple beneficiaries of the trust, and not all the beneficiaries must be disabled.

“First Party” or “Medicaid pay-back” Special Needs Trust

A special needs trust established with a disabled person’s own assets are called “self-settled” or “first party” trusts because they are funded with the disabled person’s own assets. They are often called “Medicaid pay-back trusts” because of the requirements of the federal law that authorized their creation (42 U.S.C. Sec. 1396p(d)(4)(A)). This statute (“d4A”) states that any trust established with an individual’s own assets will be treated as an “available resource” for public benefits eligibility purposes unless:

- The trust is established and funded before the beneficiary’s 65th birthday;
- It is an irrevocable trust established for the supplemental needs of a “disabled person;”
- The trust requires that discretionary distributions may be made only for the “sole benefit” of a disabled person during the lifetime of the disabled beneficiary;
- The trust is established by a “parent, grandparent, court, or a guardian” of the disabled beneficiary; and
- The trustee is required to repay the state(s) for any Medicaid benefits received by the beneficiary (up to the total remaining trust assets) prior to any distributions to remainder beneficiaries.

In spite of the restrictions, these trusts are important in special needs planning, since the disabled beneficiary can usually qualify for medical assistance through Medicaid, permitting the trust assets to be saved for the beneficiary’s other needs. Some of the situations in which they are used include:

- Lawsuit settlements;
- Gifts or inheritances received by the disabled beneficiary;
- Transfer of assets to reduce a disabled person’s existing assets to below the Medicaid eligibility limits when no other insurance is available to the disabled person.

Both types of special needs trusts must be carefully drafted by an attorney who is experienced in special needs planning for persons with disabilities. The provisions of the trusts must be carefully tailored to comply with strict SSI and Medicaid rules and in order to provide for the particular needs of the beneficiary. Selection and advising the trustee of a SNT is also important, because the distributions from the SNT are subject to complicated federal and state regulations for programs like SSI and Medicaid.