

# **PLANNING FOR INDIVIDUALS WITH SPECIAL NEEDS**

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## I. INTRODUCTION

Planning for seniors and people with disabilities often revolves around the need to access or maintain government benefits that are based on financial need (“needs based benefits”).

Social Security Retirement Benefits and pensions may provide a senior with adequate retirement income. He or she may pay for basic health care services with Medicare and a Medicare supplement. However, once there is a need for expensive prescription drugs or long term care, the person often cannot finance his or her care, and at this point there is a need for Medicaid Assistance. <sup>1</sup>Medicaid Assistance is available for single individuals who have nominal countable assets. Fortunately, there are also laws that protect the spouse at home from financial impoverishment.

A disabled person under the age of 65<sup>2</sup> who does not have a substantial work history often does not have adequate income to live even modestly without public assistance. Therefore, eligibility for Supplemental Security Income (SSI) may be crucial. Further, a disabled individual usually is not able to work at a job that provides health insurance, and so access to the Oregon Health Plan or other Medicaid Assistance program is essential. Often the health care costs for a disabled person are very high, primarily due to the costs of prescription drugs and, for some disabled individuals, the cost of long term care.

Whether we like it or not, planning for seniors and people with disabilities who do not have adequate income and resources to self-finance their living or health care needs revolves around government benefit programs.

Understanding the basics may be helpful to advisors in several scenarios: (1) an estate planning attorney may be asked to write an estate plan that leaves a portion of the recipient’s estate in trust to a disabled child or parent that will preserve their child’s quality of life and public benefits; (2) a probate attorney may be involved in a situation in which a beneficiary is about to receive benefits that will jeopardize essential public benefits; (3) a personal injury attorney will need to

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<sup>1</sup> The Medicare Part D prescription drug program has somewhat mitigated this problem.

<sup>2</sup> Use of the term “disabled person” throughout this outline assumes that the person is under the age of 65.

carefully evaluate the effect a settlement will have on the plaintiff, or the award could hurt rather than help the beneficiary; (4) a real property attorney may be involved in helping someone sell a house, and the structure of the sale could affect public benefits; (5) a financial advisor may be involved in investment decisions, such as purchase of immediate annuities, which can permanently affect a recipient's government benefits; (6) a bank's trust department may be serving as trustee of a special needs trust; (7) financial advisors may be working in a team setting with other professionals and can help identify problems and solutions; (8) the recipient may have charitable intent and/or estate tax concerns, and want to combine special needs trust and charitable giving strategies.

## II. GOVERNMENT BENEFIT PROGRAMS

### A. WHAT GOVERNMENT BENEFITS IS THE RECIPIENT RECEIVING

**1. Many Shapes and Sizes.** The first task is to identify the government benefits the recipient is receiving. The first task is to identify the government benefits the recipient is receiving. Government benefits come in many shapes and sizes. Benefits may be based on disability, age, unemployment, or workplace injury. Some benefits are "needs based" or "means tested," that is, based on financial need, while others are based on a work record.

**2. Don't Rely on the Recipient.** Getting accurate information about what government benefits the recipient is receiving can be surprisingly difficult. For example, the recipient may say the recipient is receiving Social Security Disability Income, when in fact it is Supplemental Security Income (SSI). The advisor should never rely on the recipient to accurately identify the benefits he or she is receiving. The wise approach is to require verification. It is usually a good idea to obtain a release and request the list of benefits from the caseworker.

**3. Recipient is Participating in More Than One Program.** Almost always the recipient is receiving more than one type of public benefit, and the eligibility criteria are not the same for all programs.

### B. PROGRAMS NOT BASED ON FINANCIAL NEED

If the recipient is not receiving means tested benefits, and if it does not appear that he or she will need them in a foreseeable time, then it is not necessary to do a special needs trust. Among the most common government

benefit programs that are not means tested are Social Security Benefits and its accompanying health benefit program, Medicare. The Social Security Act provides for a range of cash and health benefits, including old-age (retirement), survivor's, and disability insurance benefits. These benefits are paid to retired or disabled wage earners and their dependents, or, if the wage earner is deceased, to that person's survivors. Social Security is a public insurance benefit, and eligibility for Social Security payments is based on the earnings record of the individual (or another wage earner on whose record the individual is eligible to draw).

A Social Security beneficiary may have any amount of assets, and unearned income is not restricted. In some instances a person is eligible for such a small amount of Social Security Disability Income benefits that he/she is also eligible for Supplemental Security Income ("SSI") [see discussion regarding SSI below].

## **C. PROGRAMS BASED ON FINANCIAL NEED**

If the recipient is receiving means tested benefits, the advisor must understand what effect receipt of a lump sum or income stream will have on the benefits. Some of the most common government benefit programs for which eligibility is based on financial need are described below.

### **1. Supplemental Security Income (SSI)**

**a. Eligibility for SSI.** SSI is a federal benefit program. SSI provides a monthly cash payment in order to provide a minimum level of income for persons who are disabled, blind or age 65 or over.<sup>3</sup> The income eligibility is very low (\$674 in 2011). Further, the asset eligibility limit for an individual is \$2,000, excluding exempt assets. Exempt assets effectively include a residence, one car, household goods and furnishings, prepaid funeral plan, and term life insurance.

Funds received by SSI recipients are treated as income in the month received and an asset on the first of the month following receipt. Receipt of funds must be reported by the recipient. Technically, the receipt of funds in the first month causes an overpayment, and the Social Security Administration (SSA) will issue an overpayment notice. SSA typically administratively waives overpayments if they are under \$500.

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<sup>3</sup> 42 USC §1382

If the recipient still has the funds on the first of the following month, and if this puts him or her over the resource eligibility limit for non-exempt assets, then he or she will be ineligible for SSI. Even recipients of SSI who might feel that they can forego the monthly SSI payment once they have access to some other source of funds may decide that they must maintain their SSI because it automatically qualifies them for basic Medicaid Assistance.

If the recipient receives an income stream, his or her SSI will be reduced each month by the amount received.

**b. Spend Down.** If the recipient still has the funds on the first of the following month, and if this puts him/her over the applicable resource limit for non-exempt assets, then he or she may be ineligible for SSI. One solution to insure that the recipient actually receives a benefit from the lump-sum is to spend down. This works particularly well when the recipient will receive a relatively small amount. He or she may use the funds to purchase needed goods and services and/or to pay off any debt. Any goods purchased should be exempt assets under the Medicaid rules, such as a house, car, clothing, other tangible personal property, or a prepaid burial fund.

Timing is important, because every month that the recipient has funds in excess of the resource eligibility limits he or she will not receive government benefits, and the award or settlement can quickly dissipate. For example, if the recipient is receiving \$10,000, and will be using it to purchase a car or pay off debt, then ideally he or she will have time to accomplish this before the first of the following month. If he or she receives the funds on the 30<sup>th</sup> of the month, then spend down may not be accomplished immediately, and eligibility will be affected for the month of receipt and the following month. Ideally funds from a settlement or inheritance will be received at the beginning of the month in order to allow adequate time for spend down to be completed.

**c. Gift.** Sometimes the recipient wants to give away the funds. This will trigger a penalty period of ineligibility for SSI. The formula to determine the ineligibility period for SSI is to take the value of the gift and

divided by the monthly federal benefit rate.<sup>4</sup> The resulting number is the number of months of ineligibility. Beginning July 1, 2006, in most cases the penalty period of ineligibility began on the date of application, not the date of the gift. This long ineligibility period makes gifting in SSI cases impractical in most cases.

**d. Trusts to Preserve SSI.** In the Omnibus Reconciliation Act of 1993 (“OBRA '93”)<sup>5</sup>, Congress explicitly carved out two exceptions in the otherwise restrictive rules regarding trusts for beneficiaries of Medicaid, which Congress later adopted for SSI in the Foster Care Independence Act of 1999.<sup>6</sup> This law changed the Social Security law to adopt the exceptions in the Medicaid rules. One exception is a “payback trust” or “under 65 disability trust,” which allows disabled individuals who are under the age of 65 to place their assets in a trust provided certain criteria are met. Transfer of the individual's assets to this type of trust will not cause the trust assets to be deemed “available” for purposes of eligibility for Medicaid, nor will such a transfer cause a penalty period of ineligibility. The second exception allows a disabled individual of any age to transfer assets into a pooled trust. These exceptions are described below.

**e. Structured Settlements.** There are special issues to consider in cases involving a structured settlement. *If the claimant or the conservator is named as the direct beneficiary of an annuity purchased in the context of a structured settlement, then it could cause him or her to permanently lose eligibility for public benefits.* If the payments are “unassignable” then some government agencies will treat them as received by the individual each month even if the payments are contributed to a properly drafted special needs trust. Therefore, it is essential payments be made directly to the trustee.

**2. Medical Coverage.** A person who receives SSI automatically receives Medicaid coverage for his or her basic health care needs. He or she will receive “OHP Plus.” *Even someone who is willing to forego cash assistance may not be able to give up medical benefits. These benefits are usually essential for people with disabilities.* Maintaining some SSI, even a dollar, can

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<sup>4</sup> This amount is \$674 in 2011. There may be a very small variation in the divisor, dependent on the Oregon OSIP program.

<sup>5</sup> 42 USC §1396p

<sup>6</sup> 42 USC §1382b(e)

preserve eligibility for medical coverage.

The Oregon Health Plan Basic (OHP Basic) has varying subprograms, with different eligibility criteria. If the recipient receives an ongoing income stream as a result of taking a trust deed and note on sale of a residence or entering into a structured settlement in a personal injury case, then the income will cause ineligibility for the OHP Basic if the income is over the allowed limit. If the recipient receives a lump-sum payment, then this may cause the recipient to be over the resource limit and ineligible for OHP Basic, unless the assets are spent down or transferred to a trust.<sup>7</sup>

### **3. Medicaid Assistance for Long Term Care.**

**a. Eligibility.** Medicaid Assistance for long term care covers persons with limited income and resources who need assistance with the activities of daily living. Long term care includes nursing homes, assisted living facilities, adult foster homes, and in-home care. To meet the financial criteria, a person must meet both an income test and a resource test. Under the income test a person's gross monthly income must be at or below \$2,022 (a 2011 amount; three times the SSI standard). People over this income cap but otherwise eligible may still qualify by creating an income cap trust. The person's resources must be at or below \$2,000 for single persons. Different rules designed to avoid spousal impoverishment apply to married couples, which are based on a formula and are beyond the scope of this outline.

Similar to SSI, funds received by an individual needing long term care are treated as income in the month received and an asset on the first of the month following receipt.

**b. Spend Down.** Spend down can be a solution to preserve government benefits and still receive some benefit from a settlement or other lump-sum. The process is the same as described above under SSI.

**c. Gift.** A gift is likely to trigger a penalty period of ineligibility for Medicaid for long term care. The look back period has changed to five years. The length of the penalty period depends on the amount of the gift. A formula is used: the value of the gift is divided by \$7,663 (this amount

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<sup>7</sup> The availability and scope of the OHP Basic program is subject to the vicissitudes of the state budget, and the rules are currently changing.

changes periodically). The resulting number is the number of months of ineligibility. Beginning July 1, 2006 the penalty period of ineligibility began on the date of application, not the date of the gift.

**d. Trusts to Preserve Medicaid Assistance.** In OBRA '93, Congress explicitly carved out exceptions in the otherwise restrictive rules regarding trusts, which Congress later adopted for SSI as well (see above). Two of these exceptions, the payback trust and the pooled trust, are described below.

**4. Public and Subsidized Housing.** Many low and moderate income individuals receive assistance through federal rent subsidy programs. Rents are a percentage of monthly income, generally not more than 30%. There is no resource limit for federally subsidized housing. Eligibility is based on income, including fixed and investment income.

Since eligibility for federal housing is based on income, any situation in which the person will receive automatic payment of monthly income may make the individual ineligible for a federal housing subsidy or result in an increase in rent.

Receipt of a lump-sum will not automatically make the recipient ineligible. If the recipient immediately spends the assets on needed items or pays debts, then investment income will not be generated by the assets that would affect the recipient's monthly income. If the recipient receives a large lump-sum, and does not spend down, then the amount of investment income received or imputed to the individual will translate into increased rent or possibly even ineligibility.

**5. Food Stamps.** Food stamps is a program which provides assistance to purchase food for low income households. There are no asset limits for some participants. Eligibility for food stamps works in a similar manner to federal housing. Since eligibility for food stamps is based on income, a scenario designed to give the individual monthly income may make the individual ineligible for food stamps or reduce the benefits.

Since there is no asset limit for food stamps for persons who are eligible based on receiving certain benefits, such as SSI, receipt of a lump-sum will not automatically make the recipient ineligible. If the recipient immediately spends the assets on needed items or pays debts, then investment income will not be generated by the assets that would affect his or her monthly income. If the recipient receives a large amount, and does not spend down, then the amount of

investment income received or imputed to the individual will translate into decreased food stamps or possibly even ineligibility.

### **III. SPECIAL NEEDS TRUSTS—FIRST DETERMINE THE SOURCE OF FUNDS**

#### **A. Generally**

Special needs trusts are used to allow the beneficiary to maintain needs based public assistance and at the same time receive some benefit from the trust estate. There are many types of special needs trusts. Trusts created and funded by a third party for a recipient of public benefits are treated in some respects differently than special needs trusts that are funded with the assets of the recipient of public assistance.

Special needs trusts were developed by lawyers who realized that if a trust, by its terms, makes the trust estate *unavailable* for food and shelter, then the existence of the trust should not affect an individual's eligibility for needs based public benefits.

Eligibility for needs based public assistance programs is determined after a review of the assets and income of the person applying for help. If assets and income are *available* to the person for food and shelter, then generally the person is expected to use the available funds for those basic needs, thus reducing his or her need for government benefits.

#### **B. Trusts Funded With Third Party Assets**

Traditionally, a special needs trust was created by a third party for a named beneficiary and funded with a third party's funds, either in a will or an irrevocable living trust. The availability of trust income and principal to a recipient of public benefits in a third party funded trust will be determined based on the trust distribution standard.

If by the terms of the trust the beneficiary is given the authority to control trust principal, either on his or her own or by directing the trustee, then the trust assets may be considered an available resource.<sup>8</sup> Generally speaking, a

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<sup>8</sup> Social Security Administration's Program Operations Manual System (POMS) – SI 01120.200(D)(1)(b).

special needs trust created and funded by a third party will not be considered as an available resource. Courts that have addressed this issue look to the settlor's intent, which is evidenced in the language of the trust itself.

The settlor is not required to name the state agency to receive the remaining trust property in a trust created and funded by a third party.<sup>9</sup>

Under Oregon's current estate recovery rules, the remaining trust assets in a third party funded trust are not subject to recovery at the recipient's death.<sup>10</sup>

### **C. Under 65 Disability Trust or Payback Trust**

Congress has passed laws intended to chill the use of trusts funded with the assets of recipients of SSI and Medicaid. An inheritance, proceeds from the sale of a home, and a personal injury or wrongful death settlement will be treated as owned by the individual for purposes of eligibility for public assistance.

In the Omnibus Reconciliation Act of 1993 (OBRA '93), Congress enacted several provisions restricting the use of trusts to qualify an individual for Medicaid for long term care.<sup>11</sup> The former Health Care Financing Administration interpreted many of the provisions of OBRA '93 in its Transmittal 64. Later, in the Foster Care Independence Act of 1999 (FCIA '99), Congress enacted similar provisions restricting the use of trusts to qualify an individual for SSI.<sup>12</sup> Neither OBRA '93 nor FCIA '99 affect trusts created and funded by third parties, with the exception of some trusts created by the spouse of the recipient or for the sole benefit of a blind or disabled child when the transferor is trying to avoid transfer of assets penalties.

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<sup>9</sup> See later discussion of the “Medicaid payback trust” for purposes of eligibility for Medicaid for long term care and SSI, in which the state agency providing Medicaid must receive the remaining trust property to the extent that assistance has been provided. However, this only applies to a trust funded with the assets of the recipient.

<sup>10</sup> OAR 461-135-0832(10).

<sup>11</sup> 42 USC §1396p.

<sup>12</sup> 42 USC §1382(b)(e)(5).

Congress explicitly made an exception in both OBRA '93 and FCIA '99 for disabled beneficiaries who are under the age of 65.<sup>13</sup> These trusts have commonly been called “payback trusts” or “under 65 disability trusts.”

The key elements of a Medicaid payback trust are as follows: (a) the trust is created by a parent, grandparent, guardian/conservator, or court; (b) the individual is under 65; (c) the trust is created for the benefit of a disabled person; (d) any remaining trust balance at the death of the life beneficiary is first paid to the state agency to the extent Medicaid Assistance has been provided.<sup>14</sup>

**1. Settlor/Trustor.** Although the disabled individual is contributing the trust assets, he or she may not act as the settlor or trustor. The trust must be created by a parent, grandparent, legal guardian, or court. The term “legal guardian” is presumably intended to include a conservator in States like Oregon. ORS 125.440 specifically allows a conservator to create a trust, but only with prior court approval.

Probate court approval is always required when the recipient is a minor or mentally incapacitated. If a conservator has not been appointed, and no parent or grandparent is available, then a petition may be filed with the probate court to establish or authorize the establishment of a trust on behalf of the disabled individual.<sup>15</sup>

**2. Under 65.** The life beneficiary must be under 65 when the trust is created, but assets of the individual cannot be added to the trust after age 65.<sup>16</sup>

**3. Disabled.** The trust must be established for an individual who is disabled as defined in the Social Security Act.<sup>17</sup> If the beneficiary is receiving either Social Security Disability Income (SSDI) benefits under Title II or SSI benefits as a disabled person under Title XVI, then the State will accept this

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<sup>13</sup> See 42 USC §1396p(d)(4)(A); 42 USC §1382(b)(e)(5).

<sup>14</sup> See also OAR 461-145-0540(9).

<sup>15</sup> See section VI.A. below regarding the mechanics of obtaining a court order.

<sup>16</sup> See HCFA Transmittal 64 §3259.7.

<sup>17</sup> See 42 USC §1382c(a)(3).

determination. If the beneficiary is not receiving SSDI or SSI benefits, then the agency caseworker must make an independent determination.

**4. State Receives Remaining Trust Property.** The trust must provide that upon the death of the individual, any remaining trust property will be distributed to the State agency, up to the amount paid in Medicaid benefits on behalf of the individual. When the individual has received Medicaid benefits in more than one State, the trust “must provide that the funds remaining in the trust are distributed to each State in which the individual received Medicaid, based on the State's proportionate share of the total amount of Medicaid benefits paid by all of the States on the individual's behalf.”<sup>18</sup> FCIA '99 does not require payback of SSI, but does require the payback of Medicaid. The interest of the State in the remaining trust assets by the terms of the trust is completely separate from the right of the State to estate recovery.

#### **D. Pooled Trusts**

In Oregon, ARC of Oregon has formed a pooled trust, which is available to beneficiaries who have been disabled before the age of 65. The pooled trust is a professionally managed program. Funds are deposited into a pooled bank trust fund, although each beneficiary will have a separate account consisting of his/her separate share. Funds can be transferred to the ARC of Oregon pooled trust without the need for a separate trust created by a parent, grandparent, court, or conservator. For information about the pooled trust, call ARC of Oregon, (503) 581-2726 or toll-free at (877) 581-2726.

A non-profit association managing a pooled trust, such as The ARC of Oregon, can retain some remaining balance in the deceased beneficiary's account to be used for the benefit other disabled individuals. The ARC of Oregon's joinder agreement does now allow the non-profit organization to retain the funds.

### **IV. DISTRIBUTION STANDARD**

#### **A. Special Needs Only**

A “special needs only” standard restricts distributions to special (or supplemental) needs, expressly prohibiting distributions for basic needs. The

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<sup>18</sup> HCFA Transmittal 64 §3259.7.

term *special needs* suggests needs particular to the person and his or her disability, such as medical equipment or rehabilitative treatment, and usually special needs trusts do specify that distributions are allowed for such needs.

However, a trust limiting distributions to special needs can allow distributions for anything that is not food and shelter. This encompasses many things that are not related to a disability or medical treatment, and may not even be properly classified as a need. For example, a special need can include distributions for the cable television bill, Internet services, or vacation expenses. The term *supplemental needs* is sometimes used to perhaps more accurately describe the type of distribution that can be allowed by the terms of the trust.

Supplemental needs distributions are anything **but** food and shelter. Typically, distributions for medical expenses are limited by the terms of the trust to medical, dental, and psychological services not otherwise covered by Medicaid.

Further examples of supplemental needs are as follows: clothing, medical insurance premiums, telephone services and equipment, transportation (including automobile, auto maintenance and repair, gasoline, auto insurance, and/or bus pass), recreation, education, pet care, subscriptions, and computer equipment and services.<sup>19</sup> The list of potential distributions for supplemental needs is unlimited.

Perhaps of more use is to know what is **not** considered supplemental: rent, mortgage, property taxes, heating, gas and electric power, garbage, sewer, water, fire insurance (if required by mortgage holder), and food.

A trust limiting distributions to special needs is the safest course of action to preserve public benefits now and in the future. The trustee has clear prohibitions. The government agency worker reviewing the trust is more likely to readily recognize that the trust is not disqualifying.

## **B. Prohibiting Distributions for Basic Needs--Is It Too Restrictive?**

Is it necessary to completely prohibit distributions for basic needs? While a strict special needs trust can work well for many beneficiaries, for some

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<sup>19</sup> For more information about the operation of special needs trusts, see Donna R. Meyer, *SPECIAL NEEDS TRUSTS*, OSB CLE publication, *Administering Trusts in Oregon*, 2007.

individuals the restrictions will limit options that could substantially increase their quality of life.

For example, we may wish to write a trust for someone who is now disabled and receiving public assistance, but who later may not be disabled and no longer need public assistance. This particularly arises when writing special needs trusts for minor children, or for individuals who are mentally ill who at some point may recover or find a treatment that helps them successfully manage their symptoms. If the trust prohibits distributions for basic needs, the trustee will be breaching his/her fiduciary duty if prohibited distributions are made, even though there may no longer be a concern about whether a distribution from a trust will affect eligibility for public benefits.

As another example, the beneficiary may be receiving SSI and Medicaid, and living in substandard housing. Her parents would like to create a trust that will allow distributions for shelter, so that she can improve her living situation. The biggest concern is to maintain her Medicaid. If the trust allows the trustee to make some distributions for basic needs, then the trustee can pay for rent in a decent apartment. While her SSI will be reduced under the in-kind support and maintenance rules, she will continue to receive some SSI to pay for food and will retain her Medicaid. (See discussion re in-kind support and maintenance in section V below.)

### **C. Possible Alternatives to Strict Special Needs Trust Standard**

**1. Discretionary Support Trust.** The trust can be written to give the trustee absolute discretion to make (or refuse to make) payments for the benefit of the disabled individual. Arguably, the principal and income is unavailable because the beneficiary is unable to compel distributions for his or her basic needs. Courts that have addressed this issue look to the settlor's intent, which is evidenced in the language of the trust itself. Trust assets to which a beneficiary has no right of access (or has a limited right of access) are unavailable except to the extent of the limited actual interest.

This approach is accepted by some government agencies and in some parts of the country. The Seattle Region of the Social Security Administration, of which Oregon is a part, currently does not deny benefits to recipients of SSI who are beneficiaries of wholly discretionary support trusts. If the beneficiary cannot compel distribution under any circumstances, then the trust is not treated as a resource. Of course, an actual distribution for food or shelter will in most cases cause a reduction in benefits.

As noted above, government agencies are prone to changing policies, often without warning. Reported cases throughout the country are mixed on discretionary support trusts. There is no binding precedent in Oregon on which to rely. However, the Oregon Department of Human Services (“DHS”) challenges discretionary support trusts from time to time.

In short, if it will substantially meet the purposes of the settler, the safest course for protecting eligibility for public benefits for long term care is to restrict distributions to special needs.

**2. Purchase of Exempt Resources.** A common provision in special needs trusts allows distributions for purchase of exempt resources, such as a home or car. A provision allowing transfer of the exempt asset to the individual outright, free of trust, can be included with a trust funded with third party assets.

Can distribution of exempt resources to the beneficiary free of trust be made from a payback trust? The Seattle Region of the Social Security Administration allows distribution of exempt assets from a payback trust without penalty. However, this is not allowed in all jurisdictions.

**3. Hybrid Approach.** An intermediate approach is to clearly state that the purpose of the trust is to preserve the beneficiary’s ongoing eligibility for public benefits and to provide for the beneficiary’s special needs, but not to expressly prohibit all distributions for food and shelter. The trust provisions might also expressly allow distributions for some basic needs.

Courts typically interpret trusts in light of their express purpose. With the hybrid approach, the stated purpose is to preserve the beneficiary’s ongoing eligibility for public benefits, but flexibility is incorporated. This approach is clearly successful now for SSI beneficiaries in the Seattle Region, in which even discretionary support trusts are accepted. This hybrid standard is commonly used in Washington State. In Oregon, the Department of Human Services (“DHS”) now accepts the “hybrid” distribution standard in a third party funded trust. However, DHS has been inconsistent in its response to the hybrid standard in payback trusts.

When using this standard, it is advisable to include a provision allowing the trustee to amend the trust if necessary to accomplish the stated trust purpose, which is to preserve public benefits.

**Caution:** The practitioner should exercise extreme caution when advising the recipient about the options. When drafting any special needs trust with a distribution standard that is not strictly limited to special needs, the effect of actual distributions should be considered. For example, if an individual is receiving Social Security Disability Income and only a small amount of SSI, then even a small distribution for basic needs may disqualify the beneficiary from both SSI and Medicaid.

**4. Modification of Existing Trusts.** Oftentimes a parent dies with an estate plan which includes a testamentary trust for the benefit a child. If the child is receiving SSI, and if distributions can be made only in the sole discretion of the trustee, it may not be necessary to seek an amendment to the trust.

If an amendment is necessary, will the trust assets now be considered within the control of the beneficiary, and thus cause a disqualifying transfer unless the payback provision is included?

The current policy of the Seattle Region of the Social Security Administration is that amendment of an existing trust that does not include mandatory distributions will not be treated as a disqualifying transfer. A modification changing mandatory distributions to discretionary distributions may be treated as a disqualifying transfer.

How DHS will treat an amendment of an existing discretionary support trust to a special needs trust is unclear, and may be inconsistent with the policy of the Social Security Administration.

## V. PRACTICAL ISSUES IN ADMINISTERING TRUSTS

### A. In-Kind Support and Maintenance

**1. Generally.** In-kind support and maintenance (ISM) is food or shelter or anything that may be used to acquire these necessities that is provided by a third party at a reduced rate or no cost to the recipient.<sup>20</sup> Thus, an individual receives ISM when he or she receives food or shelter directly without having paid for it or receives these items because someone else pays for it.<sup>21</sup>

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<sup>20</sup> 42 USC §1382a(a)(2)(A); 20 CFR §416.1102

<sup>21</sup> 20 CFR §416.1130(b).

Generally, SSI benefits will be reduced in cases where the individual is not paying the full cost for his or her food and shelter. In-kind income is normally valued at the current market rate. However, two rules govern how ISM will affect the SSI benefit: the one-third reduction rule (VTR) and the presumed maximum value rule (PMV). The composition of the household will determine whether the VTR rule or the PMV rule will apply.<sup>22</sup>

The VTR rule applies only when the SSI recipient lives in another person's household and receives both food and shelter from that person.<sup>23</sup> When this applies, the actual value of the in-kind income is not used. Rather, SSA reduces the SSI benefit by an amount equal to one-third of the FBR for SSI. The SSI benefit will not be reduced more than one-third of the FBR. The one-third reduction applies in full or not at all.

When a special needs trust pays for food or shelter, the PMV rule applies. Under that rule, when a special needs trust (or any third party) pays a beneficiary's food or shelter costs, the SSI will be reduced by the lesser of the one-third benefit rate plus the \$20 general income exclusion or the actual value of what was received.<sup>24</sup>

**2. The Home.** As stated above, the home in which the individual (or spouse or minor child) resides or intends to return to is an exempt asset for SSI and Medicaid purposes.<sup>25</sup> Therefore, the trust beneficiary may not be adversely affected by having outright title to a home. If the trust is a "payback trust" as recognized by federal and State law, it may be preferable to keep the home outside of the trust because the remainder beneficiary is the State that provided Medicaid assistance.

On the other hand, there are often good reasons for including the home as an asset of the trust. For example, the settlor of a third-party funded special needs trust may have specifically included the home as an asset, thereby allowing the settlor to determine the ultimate distribution upon the death of the special needs beneficiary. More commonly, the home is included because the

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<sup>22</sup> 20 CFR §416.1130(a).

<sup>23</sup> 20 CFR §416.1131.

<sup>24</sup> 20 CFR §416.1140.

<sup>25</sup> 20CFR §416.1212.

beneficiary lacks the capacity or judgment to manage such a significant asset.

Treatment of a house owned by a trust has been a source of considerable confusion. Social Security Administration helped clarify the rule regarding home ownership by a trust in the POMS. Under the POMS, a home-owning trust is not an outside source providing shelter to the beneficiary because the beneficiary “would be considered to be living in his/her own home based on having an ‘equitable ownership under a trust.’”<sup>26</sup> However, to the extent that the trust pays for the mortgage, property taxes, homeowner’s insurance and utilities from the trust assets, the PMV rule will apply.<sup>27</sup>

If the trust pays for improvements to the home, the individual does not receive income. Disbursements for improvements increase the value of the resource and thus do not provide ISM.<sup>28</sup>

**3. Food.** Distributions from a special needs trust for food can be treated as ISM. Are there exceptions to this? Food while on vacation can be treated as an exception under the “temporary absence” rule.<sup>29</sup>

**B. Gift Cards.** Gift cards are usually treated as cash equivalents. If the individual can use the card to buy food or shelter directly (for example a restaurant, grocery store or VISA gift card), it is unearned income (and a resource in the next month). If the store does not sell food or shelter items (for example a bookstore or electronics store), but the card does not have a legally enforceable prohibition on the individual selling the card for cash, then it is still unearned income.<sup>30</sup>

**C. Credit Cards.** If a trust pays a credit card bill for the trust beneficiary, whether or not the individual receives income depends on what was on the bill. If the trust pays for food or shelter items on the bill, the individual will generally be charged with in-kind support and maintenance up to the PMV. If the bill includes non-shelter items, the individual usually does not receive income as the result of

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<sup>26</sup> POMS SI 01120.200F(1).

<sup>27</sup> POMS SI 01120.200F(3)(b) and (c).

<sup>28</sup> POMS SI 01120.200F(3)(c).

<sup>29</sup> POMS SI 00835.040.

<sup>30</sup> POMS SI 00830.522.

the payment unless the item received would not be a totally or partially excluded non-liquid resource in the following month. For example, if the credit card bill includes restaurant charges, payment of those charges results in ISM. If the bill also includes purchase of clothing, payment for the clothing is not income.

#### **D. Distributions for Companions--the Disneyland Question**

If a disabled individual is unable to travel alone, can the trust pay for the travel costs for a companion to accompany him or her, knowing that the companion is also benefitting from the trip? This should not be a problem, even though the companion may be a relative or friend of the beneficiary.

#### **E. Transfer of an IRA to a Payback Trust**

It appears that the transfer of an individual's own IRA to a special needs trust is a taxable event. However, there is at least one Private Letter Ruling (PLR) in which the IRS approved a transfer of an *inherited* IRA to a special needs trust.<sup>31</sup> Although PLRs do not have precedential value, the PLR does suggest that this approach is possible.

### **VI. COURT INVOLVEMENT IS NEEDED**

**A. Mechanics of Court Approval of Trusts.** In some instances, a disabled individual is not mentally incapacitated, and court approval is not required to fund a trust and preserve Medicaid assistance. However, court approval is required when a trust is being created for a minor or mentally incapacitated person with his or her own funds.

Multnomah County probate court policy is that the "presumed" vehicle for maintaining the funds from a settlement in a civil action involving minors or incapacitated adults will be a conservatorship. However, the court will consider requests involving payback trusts for individuals receiving public assistance.

In some probate courts the practice of the probate court has been to require an ongoing conservator to which the trustee must report each year, who then files the annual accounting to the court. Typically the conservator and trustee are the same person or professional trustee.

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<sup>31</sup> PLR 201116005

In other counties in Oregon, an ongoing conservatorship has not been necessary. Petitions have been filed under ORS 125.650(1), which allows the court to exercise any power that could be exercised by a conservator in a protective proceeding (in this case, the power to create a trust under ORS 125.440). ORS 125.650(5) also allows the court to authorize, direct, or ratify any “contract, trust or other transaction relating to the protected person's financial affairs...”

A revision to ORS 125.440(2) became effective January 1, 2008, which allows a conservatorship to create a trust even if it will have the effect of terminating the trust in the following circumstances:

- (a) The trust is created for the purpose of qualifying the protected person for needs-based government benefits or maintaining the eligibility of the protected person for needs-based government benefits;
- (b) The value of the conservatorship estate, including the amount to be transferred to the trust, does not exceed \$50,000;
- (c) The purpose of establishing the conservatorship was to create the trust; **or**
- (d) The conservator shows other good cause to the court.

## **B. Structured Settlements--Special Issues**

If a special needs trust is contemplated in the context of a personal injury (PI) or wrongful death award, it is critical that the PI lawyer contact the trust lawyer before settling the case. The PI lawyer may obtain a good settlement or award for the recipient, but the recipient may realize no benefit if the process isn't handled correctly.

First, if a structured settlement is arranged naming the claimant or the conservator as the direct beneficiary, then it could cause him or her to permanently lose eligibility for public benefits. While the periodic payments can be assigned to the trust after the purchase of an annuity, some government agencies will treat the payments as constructively received by the individual.

Second, it is possible that an award or settlement will be treated as an available resource during the pendency of a proceeding in the court to establish

the trust.

These outcomes can both be avoided if the PI lawyer recognizes the problem sufficiently ahead of the settlement to engage the trust lawyer. The trust lawyer can then identify whether the beneficiary is in fact receiving needs based government benefits, help the PI lawyer and the injured party decide on a plan, and then obtain court approval, if needed, prior to or contemporaneous with the settlement.

## **VIII. SPECIAL NEEDS CONSIDERATIONS AND CHARITABLE GIVING<sup>32</sup>**

### **A. Charitable Remainder Trusts**

Revenue Ruling 2002-20 allows distributions from a charitable remainder trust (CRT) to a second trust, such as a special needs trust, for the life of someone who is “financially disabled.” Charitable remainder trusts generally have to make distributions for an individual for his or her life, or to another trust for a term of no more than 20 years. This was problematical for people who were planning for disabled loved ones, and this ruling solved these problems. The income stream must be paid for the life of a financially disabled individual to a separate trust. The ruling clarifies that for charitable trust purposes the beneficiary is treated as if he or she directly received the income.

A person is “financially disabled” if he or she is unable to handle his or her own financial affairs by reason of a medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. All individuals who receive SSI or SSDI based on disability meet this test.

Revenue Ruling 2002-20 outlined three situations. One of them involved a charitable remainder trust making payments to a support trust for the life of the beneficiary. At the beneficiary’s death the balance would be paid to the

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<sup>32</sup> See Barr, Katherine N.; Lovelace, Renée Colwill; Todd, Judith F., **PLANNING FOR CHILDREN AND ADULTS WITH DISABILITIES: THE BENEFITS OF COMBINING CHARITABLE PLANNING AND SPECIAL NEEDS TRUSTS**, (National Committee on Planned Giving, Journal of Gift Planning, Volume 10, Number 3, September 2006) and Lovelace, Renée Colwill, **CHARITABLE TRUSTS AND SPECIAL NEEDS**, (American Bar Association Estate Planning Symposia, May 12-14, 2004).

beneficiary's estate. This would be useful in those circumstances in which the beneficiary meets the financially disabled test but is not going to ever need or qualify for government benefits based on financial need.

The second situation involved a CRT making payments to a special needs trust created and funded by a third party. The amount remaining in the special needs trust at the beneficiary's death must be paid to his or her estate.

The third situation involved a payback trust, in which the balance is paid to Medicaid to the extent assistance is provided, and then to other beneficiaries, including charity.

One reason to consider a charitable trust in the context of special needs is to provide a "replenishment funding stream." Rather than fund the trust with a large amount of money, subject to management over a long period of time, the special needs trust can be funded with a smaller initial amount, and the CRT will replenish the income.

## **B. Charitable Lead Annuity**

PLR 199903001 gives an example of the use of charitable lead annuities in the context of special needs. In that case there were a series of gifts from an estate to charities, with staggered terms. The remainder interests were payable to a special needs trust.

## **C. Charitable Gift Annuity**

A less expensive and simpler method of combining charitable and special needs planning is the use of a charitable gift annuity. The gift is made by the donor to the charity, and the charity makes the stream of payments to a special needs trust.

As another example, sometimes a senior or disabled individual doesn't receive public benefits based on financial need, but could benefit from a simple estate planning vehicle that won't require ongoing management. A charitable gift annuity provides a mechanism for a person with charitable intent to receive income and qualify for an immediate income tax deduction. It also protects the funds from being squandered, or the donor from being taken advantage of if the nature of the disability may make him/her susceptible to financial abuse.