



# Special Needs Trust Planning

By Ronnie E. Webb Jr.

**S**pecial needs trust planning plays an important role in any law practice involving estate planning or administration. Even for the attorney whose practice involves only a limited amount of estate planning, it is necessary to discuss special needs trusts with the client in order to determine whether the client, or any potential beneficiary of the client's estate, may have special needs. If special needs planning is not relevant to a client when executing the initial estate plan, discussing special needs trust planning may remind the client that the estate plan may need to be amended to protect certain benefits should a beneficiary develop a special need in the future. In fact, some practitioners believe that the failure to discuss special needs trust planning with your client could result in malpractice if a beneficiary is disqualified from benefits at the client's death.

Individuals with special needs and limited resources may qualify, or may already be receiving, means-tested governmental benefits such as Supplemental Security Income (SSI) and Medicaid. (A special needs trust is intended for beneficiaries who qualify for governmental benefits as a result of their special needs and generally must meet the Social Security Administration definition of disability; for more, see the article "Social Security Disability Practice" on page 30.) Though it may differ by state and by program, generally a person can qualify for governmental benefits if he or she is unable to maintain employment because of a disability and has available resources below \$2,000.

If an individual who is receiving governmental means-tested benefits obtains assets, for example from the proceeds of a lawsuit or an inheritance, this individual can be disqualified from public benefits. A properly drafted special needs trust can shelter these assets so the individual can maintain benefits. The assets in the special needs trust will be used to supplement the benefits, not replace them, by allowing the trustee to make distributions to pay expenses not covered by the public benefits. The objective of a special needs trust is to improve the disabled individual's overall quality of life by making the assets in the trust available for the beneficiary to pay for those things not paid by the public benefits.

In order for a trust to qualify as a special needs trust, several requirements are necessary. The assets of a special needs trust should not be intended to provide basic support (food and shelter) for the beneficiary. The trustee must have absolute discretion over the distribution of the trust assets. A special needs trust should not contain any rights of withdrawal or the right for the beneficiary, or any person acting on behalf of the beneficiary, to demand distributions from the trust. The beneficiary cannot have the right to amend or revoke the trust. Finally, the trustee should make distributions from the trust for the benefit of the beneficiary but should not have the ability to make distributions of cash directly to the beneficiary as this could result in a dollar-for-dollar reduction of SSI benefits and could disqualify the beneficiary for other benefits.

This article discusses three types of special needs trusts: first-party special needs trusts, pooled special needs trusts, and third-party special needs trusts.

### FIRST-PARTY SPECIAL NEEDS TRUSTS

A first-party special needs trust, also referred to as a “(d)(4)(A)” trust, is an irrevocable trust created pursuant to federal law as a self-settled trust for the sole benefit of the disabled person. 42 U.S.C. § 1396(p)(d)(4)(A). The beneficiary must be a disabled person, as defined in the Social Security Act, and must be under the age of 65 at the time the trust is funded.

A disabled person’s assets are used to fund a first-party special needs trust in order to allow the beneficiary to qualify for, or to preserve, government means-tested benefits. This type of trust is generally used when a disabled person receives assets such as proceeds from a personal injury lawsuit or settlement, from a medical malpractice lawsuit or settlement, or from an inheritance that is received outright. A (d)(4)(A) trust can be funded with many types of assets such as real estate, vehicles, and various types of investment accounts.

for approval by the court to establish the trust.

A first-party special needs trust is funded with the disabled person’s own assets, and federal law requires that a first-party special needs trust contain a “payback provision.” The payback provision requires that the trustee, upon termination of a first-party special needs trust, reimburse any state Medicaid agency up to the amount of the total medical assistance paid to or on behalf of the disabled individual by the Medicaid agency during the disabled person’s life.

Prior to reimbursement to Medicaid, the trustee is allowed to pay all the federal and state taxes due because of the death of the beneficiary and any administrative expenses and costs related to the termination of the trust. However, because the state Medicaid agency is not a remainder beneficiary, but instead a creditor of the trust, the Medicaid reimbursement has priority over distributions to remainder beneficiaries and even funeral expenses. Therefore, it is advisable that prepaid funeral and burial plans are purchased before the beneficiary’s death.

A first-party special needs trust

made without the proper authority under the trust, then the trustee could be personally liable to pay back the state for amounts that were distributed inappropriately.

The trustee of a (d)(4)(A) trust can be any qualified bank, trust company, or individual, including the disabled person’s parent, relative, or friend. However, because the trustee of a special needs trust has to administer the trust for the sole benefit of the beneficiary and for the purpose of providing for the beneficiary without causing disqualification of public benefits, it is advisable that a trustee with specific experience administering a special needs trust be appointed.

### POOLED SPECIAL NEEDS TRUSTS

A pooled special needs trust, also referred to as a “(d)(4)(C)” trust, is an irrevocable trust, pursuant to federal law, established and managed by a nonprofit organization. 42 U.S.C. § 1396(p)(d)(4)(C). The pooled special needs trust consists of a master trust agreement that sets forth the terms of the special needs trust. A disabled person creates a sub-account in the pooled trust by signing a joinder agreement and thereby becomes a beneficiary under the trust, along with other disabled beneficiaries who have joined the pooled trust. The disabled person’s assets are pooled together with the other beneficiaries’ sub-accounts for efficient investment and management of the funds.

A pooled special needs trust, like the first-party special needs trust, is also considered a self-settled trust and requires a payback provision to reimburse Medicaid. The joinder agreement can be established by a parent, grandparent, guardian, court, or the individual beneficiary. The trustee of a pooled trust is predetermined in the master trust agreement. Pooled trusts generally can only be funded with cash. Finally, unless your state has a rule to the contrary, a beneficiary of a pooled trust cannot be over the age of 65 when the trust is funded.

The administration costs and costs to establish a (d)(4)(C) pooled special needs trust are generally less than those for a (d)(4)(A) trust. Therefore, pooled trusts can be more efficient to administer than

**A trustee could be personally liable to pay back Medicaid for funds that were distributed inappropriately.**



Pursuant to the statute, a (d)(4)(A) special needs trust requires that the grantor be either a parent, grandparent, guardian, or the court. If the disabled beneficiary does not have a living parent or grandparent, the disabled person cannot be the grantor even though the trust is considered a self-settled trust. Accordingly, in order to establish a (d)(4)(A) trust, a court proceeding may be necessary either to establish a guardianship for the disabled beneficiary or

requires that the disabled beneficiary be the “sole” beneficiary of the trust. The trustee is generally prohibited from making distributions from the trust that benefit anyone other than the disabled beneficiary. If there are not enough trust assets to pay back the entire amount due to Medicaid upon the termination of the trust, and if the state Medicaid agency determines that distributions were made by the trustee that were not for the sole benefit of the beneficiary, or that were

a (d)(4)(A) special needs trusts and are good alternatives if the amount of money funding the trust is relatively small. Because the disabled person or his or her agent under a well-drafted power of attorney can sign the joinder agreement, this type of trust is also efficient if the disabled person has no living parents and grandparents; it can be established without a court proceeding. However, because a (d)(4)(C) trust can only be funded with cash, a pooled trust may not be an option for a beneficiary who owns other types of assets that would cause disqualification of public benefits, such as certain real estate or specific investment accounts that the beneficiary does not want to liquidate.

### THIRD-PARTY SPECIAL NEEDS TRUSTS

A third-party special needs trust is created pursuant to state law, not federal law, and is funded with assets belonging to a third party, such as the disabled person's immediate family, friends, and other relatives. There are no age restrictions, so a third-party special needs trust can be established for a beneficiary who is over the age of 65. The most common assets that fund a third-party special needs trust come from an inheritance upon the death of the grantor, but assets can also be gifts made directly into the trust from any third party. Like first-party special needs trusts, a third-party special needs trust will shelter assets so the disabled beneficiary can apply for or maintain public benefits.

Third-party special needs trusts can be either a testamentary trust, which is established upon the death of the testator, or a stand-alone special needs trust established by the grantor during his or her life. A benefit of using a stand-alone trust is that the trust exists not only to retain assets upon the death of the grantor but can be funded with gifts during the life of the grantor, from the grantor or another person. Further, the stand-alone third-party special needs trust can be named as a beneficiary under life insurance policies and other financial accounts and can be named the beneficiary of another person's estate plan, such as a grandparent or a friend.

Third-party special needs trusts are

not funded with the disabled person's own assets, so there is no payback requirement to Medicaid. Because a third-party special needs trust does not have to account for a Medicaid payback, the funds can be used to benefit beneficiaries other than the disabled beneficiary, if the grantor so chooses. Therefore, for example, a trustee could be granted the authority to pay the travel and entertainment costs of friends and other family members to encourage them to interact with the disabled beneficiary more frequently.

If any beneficiary of an estate or trust is receiving public benefits and the inheritance is not passed to a special needs trust, then the disabled beneficiary will likely be disqualified from the means-tested public benefits. Even though the disabled beneficiary may be able to shelter the funds in a first-party special needs trust, the first-party special needs trust will contain a payback provision; further, if the beneficiary is over the age of 65 when the trust is to be funded, a first-party special needs trust cannot be established because of the age restrictions. Therefore, utilizing a third-party special needs trust in an estate plan can be very advantageous to a beneficiary with special needs.

### PROTECT YOUR CLIENTS AND THEIR LOVED ONES

Although not every estate plan will need to utilize special needs trust planning, it is important that the practitioner be aware of the options available to clients who have or may have a special needs heir, legatee, or beneficiary. Discussing special needs trust planning with your clients will undoubtedly add value to the legal services you are providing and will serve to protect many beneficiaries from losing valuable benefits.

*Disclaimer: This article is intended to be an overview of special needs trust planning and is not intended to be an in-depth discussion of the drafting, administration, or tax issues related to special needs trusts. State laws differ as to the use of special needs trust planning. Therefore, you should review the law in your state for specific rules and regulations regarding special needs trusts drafting and administration. ■*

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