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Special Needs Trusts

We all have a desire to provide for our loved ones. We do this by gift giving during our lifetimes or by a bequest at our deaths. However, there are many factors to consider when planning for family members who have special needs.

One of the most basic vehicles for property distribution is a Special Needs Trust (SNT). There are a number of ways an SNT can be created, however the two most often utilized are the third-party trust and the self-created trust. This article will discuss some of the factors of the third-party trust (since this is a general discussion, it is not intended to be a thorough presentation of all issues concerning SNT's; nor is it intended to address issues concerning eligibility rules for public benefits or the public benefits themselves.).

A third-party trust is created by a grantor who wants to provide for the special needs beneficiary without having the assets cause disqualification of the beneficiary receiving public benefits. The trust assets may supplement public benefits but must not be intended to replace these benefits. Therefore, the trustee of the trust must have the sole discretion as to the use or distribution of the trust assets. Legally, the assets must be unavailable to the beneficiary. In other words, the beneficiary cannot compel the distribution of the principal or the income of the assets. The discretion of the trustee to make payments for the benefit of the beneficiary must be total and nonreviewable. No person or entity, including a judge, should have the power or authority to substitute his or her judgment for the discretionary decisions made by the trustee.

Furthermore, the trust cannot be used for the basic support of the beneficiary. In fact, the trust assets must only be available for the special needs of the beneficiary. These are usually defined as assets used to maintain the beneficiary's happiness, comfort and luxuries of life when these items are not provided by public benefits. Language may state the assets may be used to best enable the beneficiary to lead as normal, comfortable, dignified, and fulfilling a life as possible.

SNT's can be established during the lifetime of the grantor, or they can be found in the grantor's Will or Revocable Living Trust. If done during the lifetime of the grantor, the vehicle used is normally an irrevocable trust. This trust is commonly referred to as a "stand-alone trust." It can be funded with gifts from parents, grandparents or any other individual. It can also be the document to receive bequests from someone's Will or Revocable Living Trust. Finally, it can be the proper vehicle to hold life insurance for the benefit of the special needs individual.

When the SNT is placed in a testamentary document (will or living trust), it is part of the general distribution plan of the grantor. Whether to use a will or a living trust is a decision to be made by the grantor. Again, this issue cannot be adequately treated in this article. However, please be aware that there are distinctions and they should be discussed with the preparer of your estate planning documents.

An SNT usually contains provisions dealing with the termination of the trust. This can be accomplished during the lifetime of the beneficiary or at his or her death. For example, what if the beneficiary's interest in the trust disqualifies the beneficiary from receiving public benefits? Or what if the beneficiary ceases to be deemed "disabled"? Furthermore, provisions should be included to distribute the remaining trust assets after the beneficiary dies. Designation of a trust protector and a trust advocate is also very important.

It is extremely important that the grantor seek professional assistance in the preparation of an SNT. The advisor must obtain adequate information regarding the beneficiary's special needs and the public benefits being received or may be received in the future. Finally, and equally important, the grantor's wishes and desires need to be expressed to the advisor. Only then can a proper estate plan be formulated for the benefit of the special needs beneficiary.

We all have a desire to provide for our loved ones. We do this by gift giving during our lifetimes or by a bequest at our deaths. However, there are many factors to consider when planning for family members who have special needs.

One of the most basic vehicles for property distribution is a Special Needs Trust (SNT). We will review the basics of self-created trusts. Again, since this is a general discussion, it is not intended to be a thorough presentation of all issues concerning this type of trust; nor is it intended to address issues concerning eligibility rules for public benefits or the public benefits themselves..

As people aged they sometimes had the need to receive government benefits such as Medicaid. However, programs such as Medicaid were (and still are) known as mean-tested benefits. In other words, these benefits are available to people with minimal income and minimal assets or resources. If a person possessed assets over a certain amount, that person would be ineligible to receive these benefits. Historically, individuals attempted to create discretionary trusts using their own funds without losing their entitlement to public assistance. They tried to shelter these assets in this type of trust vehicle.

However, this technique worked very infrequently. Case law usually found that these self-created discretionary trusts remained available to the trustmakers and, therefore, remained available to the trustmakers creditors, including the government. Therefore, the assets in these trusts were countable assets for government benefit purposes. This was true in many cases, but there was no uniform national policy or law dealing with these trusts. This all changed in 1993. In that year, Congress passed the Omnibus Budget Reconciliation Act (OBRA 1993).

Under this legislation, assets in certain trusts were deemed to be protected as noncountable assets for government benefit purposes. This was especially true for disabled persons who had financial needs beyond essential medical care. OBRA now permitted the retention of resources of a disabled person in a trust without those assets disqualifying the person from receiving government benefits such as Medicaid.

There are two trusts that can be used with the disabled persons assets. One is a "payback trust" and the other is a pooled or "pay-to trust". With a "pay-to trust" when the beneficiary dies the remaining assets may be distributed to the nonprofit association that managed the assets. If the trustmaker does not want the assets going to this association, then the assets will be used to reimburse the state for the funds provided to the beneficiary for medical care during the beneficiary's lifetime. We will spend more time with pooled trusts in a later article.

The "payback trust" is the more commonly used trust. Here too, the state may reimburse itself from the remaining assets in the trust in an amount equal to the medical benefits the state has provided during the beneficiary's lifetime. This OBRA trust can be created by the beneficiary, his or her parents, grandparents, legal guardian or a court (in many cases the funds are the result of a successful personal injury lawsuit). Under the legislation, the beneficiary must be under the age of sixty-five years and be disabled under federal law definition. It is a wonderful vehicle to shelter the beneficiary's assets so that he or she can receive government benefits.

In both trust situations, the assets must be placed in a special needs trust. That is the the trust assets may supplement public benefits but must not be intended to replace these benefits. The trust mechanism would, therefore, be similar to the third-party created special needs trust.

To repeat the criteria, the trustee of the trust must have the sole discretion as to the use or distribution of the trust assets. Legally, the assets must be unavailable to the beneficiary. In other words, the beneficiary cannot compel the distribution of the principal or the income of the assets. The discretion of the trustee to make payments for the benefit of the beneficiary must be total and nonreviewable. No person or entity, including a judge, should have the power or authority to substitute his or her judgment for the discretionary decisions made by the trustee.

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As stated earlier, it is extremely important that the creator of the trust seek professional assistance in the preparation of an SNT. The advisor must obtain adequate information regarding the beneficiary's special needs and the public benefits being received or may be received in the future. Finally, and equally important, the grantor's wishes and desires need to be expressed to the advisor. Only then can a proper estate plan be formulated for the benefit of the special needs beneficiary.