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Using a "Special Needs" Trust to Manage the Inheritance of a Disabled Beneficiary and Preserve Sources of Public Assistance

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I've seen it time and time again. The estate planning attorney meets with his or her clients for the first time to gather facts and discuss the clients' objectives. The clients are the parents of several children, one of whom is mentally ill. The disabled child resides in an out-of-state institution and receives public assistance. The attorney prepares an elaborate set of documents which include a will and a trust which solve all of the client's estate tax problems. After an exhausting session of document review and grappling with different tax concepts, the mother asks: "What special provisions have you made for my disabled child?" The attorney explains that on the second of the two parent's deaths, their property is to be inherited in equal shares by all of their children if they are then living. The disabled child and each well child is to split the net inheritance between them. Each is to receive an outright distribution of his or her share. The parents wonder if there is a better way. However, as lay people, they are inclined to accept the attorney's advice.

What's wrong with this picture? The attorney failed to recognize that the disabled beneficiary's special needs require special planning. While the attorney's assumption that the parents would want to treat each of their children "fairly" by treating each equally and showing no favoritism is understandable, the plan can produce extremely negative results by disqualifying the disabled beneficiary for public assistance benefits. This can interrupt and disrupt the lifestyle the beneficiary has become accustomed to and relied on, unnecessarily divert the family wealth from purposes the family may have preferred to serve, and cause hard feelings among family members after the parents' deaths.

Planning for the welfare and well being of a disabled family member may be regarded as a subspecialty within the estate planning field. It requires experience and understanding of not only the basic principles of trust and estate law, but also the complicated rules governing public assistance eligibility which is more the domain of "poverty lawyers" than attorneys in private firms accustomed to drafting wills and trusts for wealthy clients. It also requires a familiarity with the support network available to disabled persons through non-profit

advocacy groups and service providers. Perhaps most importantly, it requires an empathy and an understanding of the unique psychology of families with special needs children.

Thus, several nuances in this "niche" area of the law make particularly perilous the process of planning for the establishment and maintenance of inheritances or gifts earmarked for a special needs beneficiary. Attorneys and other professionals working with the disabled refer to the trust arrangements typically used to achieve those purposes variously as "special needs", "supplemental needs", "amenities" or "luxuries" trusts. The planning goal is to establish and fund a special needs trust from which distributions can be made to or for the benefit of the disabled beneficiary without jeopardizing sources of public assistance that are or may be available to provide for basics needs such as food, clothing, shelter and essential medical care provided under programs such as Medicaid, SSI and SSDI, and the state and local programs which usually also apply the SSI eligibility criteria. The trust should also establish mechanisms to protect the interests of the special needs beneficiary during periods when he or she is not able to do so him or herself, and to discover and obtain benefits and maximize resources from sources outside of the trust which might be available to the beneficiary. This mechanism would include the appointment of various trustees, needs monitors and "protectors". In this way, the trust establishes a financial and personal support network designed to ensure that all of the beneficiary's special needs are met and that available external resources are maximized.

The purpose of this memorandum is to explore issues relating to the funding and design of special needs trust for beneficiaries whose mental or physical disabilities are of such a nature and extent to render them dependent on special living arrangements, medical care or other services for which public assistance is available.

A. Assembling the Players.

Like any other trust, a special needs trust will require a trustee to manage the trust property for the benefit of the disabled beneficiary. Under normal circumstances the relationship between trustee and beneficiary is characterized by understanding and communication. The beneficiary can be expected to understand the trust and his or her rights relative to income and principal distributions. The beneficiary will freely communicate with the trustee concerning needs and desires such that there will be little, if any, time elapsed between a beneficiary's identification of a need and a trustee's distribution of trust property (if the trust's documents permits it) to meet that need.

By contrast, a special needs beneficiary cannot always be

expected to understand the trust or his or her rights, or to communicate needs and desires to the Trustee. Indeed, in some circumstances the beneficiary may not be fully aware of his or her needs. For special needs beneficiaries who may qualify for public assistance, the communication gap problem is compounded because the beneficiary might not be aware of sources of public assistance outside the trust which may be available. Finally, the special needs beneficiaries are less apt to complain about a trustee's lack of communication, unresponsiveness, or even a breach of its duties. Unlike other beneficiaries, the special needs beneficiary cannot be expected to hold the trustee accountable, remove an arrogant, dishonest or non-communicative trustee, or take other actions to protect his or her interests.

For this reason, it is important for the client to spend the time and effort necessary to carefully select several "players" to perform various functions and roles in the administration of the trust and monitoring of the beneficiary's needs, advocating his or her rights, and protecting his or her interests.

1. Trustee Selection. First, the client should devote some time and effort to the selection of a suitable trustee. Many of my clients without special needs beneficiaries are cavalier about their choice of trustee. They are apt to name the bank at which they do their commercial and retail banking without so much as interviewing the trust personnel. I would not condone this practice for any estate planning client. But it is particularly dangerous where one or more of the client's trust beneficiaries have special needs.

Clients should make the effort to identify a select group of corporate trustees in the locality in which the disabled beneficiary will reside who have demonstrated the compassion, bedside manner and experience needed to properly administer special needs trusts. The trustee selected should be domiciled in the beneficiary's locality, which may or may not be located outside the State of New Hampshire. It is sometimes important not to choose a geographically remote trustee because the Trustee's personnel must be willing and able to leave the office and visit the beneficiary from time to time. They also must be available for face to face meetings with the other players, including the advocate/needs monitor and trust protector described below. A good place to start in developing a "short list" of prospective trustees is to inquire of social service agencies or advocacy groups located in the beneficiary's town or city. The Association of Retarded Citizens and the Alliance for the Mentally Ill, for example, often have local chapters in states or cities which are large enough to support them.

2. Needs Monitor. Second, the parents should arrange for someone other than the Trustee to be the beneficiary's "needs

monitor". The role of a needs monitor is to check on the beneficiary regularly, determine whether public assistance being provided is adequate to meet the beneficiary's basic needs, and also judge whether the beneficiary is receiving sufficient distributions from the special needs trust to satisfy the beneficiary's supplemental needs. If the beneficiary requires supplemental distributions from the trust for personal care or amenities - such as travel, special foods, stereos and televisions, a private room, etc. - the needs monitor will communicate this to the Trustee and be sure that the request is honored promptly. The needs monitor will be available to consult with family members to update them on the beneficiary's condition and accept suggestions from them.

There may be some professional needs monitors in the beneficiary's community. In addition to compiling a short list of trustees, the clients' local contacts in the social service and advocacy community will also consult on whether the locality has available the equivalent of the New Hampshire Office of Public Guardian, or a similar public or quasi-public agency or social worker that might serve in a similar capacity for a modest fee. If there are no professional needs monitors available, the client may choose a nonprofessional. Remember, however, that a lay person such as a friend of the beneficiary may prove unreliable or negligent, or may relocate or resign. The trust document should provide for the appointment for a successor needs monitor - probably giving the beneficiary's well siblings (if any) the power to fill a vacancy after they have conducted an investigation. It is also often a good idea to give the siblings the power to remove the needs monitor with or without cause. In any event, the client need not worry about dishonesty because the needs monitor will not be handling any money. That function would be delegated exclusively to the Trustee.

3. Trust Protector. The third possible player might be a "trust protector". Unlike the Trustee and monitor, the protector would not be involved in day to day activities. Rather, the protector would serve in an oversight role to insure that the beneficiary's needs are being met and that the monitor and the Trustee are both diligently and honestly fulfilling their responsibilities. The protector would receive "accountings" filed by the Trustee - summaries of income, expenses, trust disbursements and investments - which the protector could receive from the Trustee as frequently as monthly. The trust document might require the monitor to make monthly reports of actions taken on the beneficiary's behalf. These "status reports" and accountings might be provided to the protector on a quarterly basis, if more convenient for all parties. One or more of the beneficiary's well siblings, if any, might be good candidates to serve as the protector or protectors. Serving in this general oversight role does not require the designated family members to be directly involved in the beneficiary's day to day activities, or deal with the beneficiary's daily trials and tribulations - something that could be stressful for the chosen

family members and create tension among them or bitterness towards the beneficiary. If the client is still uncomfortable imposing this responsibility on the beneficiary's well siblings or other family members, or if there are no family members willing or able to serve as protector, the clients could look outside the family for a professional trust protector such as a case worker with the local Alliance for the Mentally Ill.

Regardless of whom the clients choose to serve in these various roles, it is important to remember that none of this is written in stone. Parents may make choices based on today's facts which could be obsolete on the second of their deaths when the beneficiary's special needs trust is funded (if the trust is to be created and funded only at that time under the parents' "revocable trusts"). The parents retain the flexibility throughout their lifetimes to amend the trust to substitute other people or institutions for those previously designated or make any other changes, for that matter. And, after their deaths, the parents can provide a trusted person or institution - such as their well children - with the same removal and replacement powers as are described above in connection with the needs monitor.

B. Trust Funding. This is the most difficult decision most clients face. Many of them start with the assumption shared by the hypothetical parents introduced at the beginning of this memorandum: that all of their children (including the disabled child) will inherit equal shares of the parents' estates. Other parents attempt to provide the inheritance in accordance with need, and not equality. They look at the disabled child's special needs relative to the needs of the well children and instinctively determine that the disabled child should take a disproportionately large share of the inheritance. The well children should receive whatever remains. In extreme cases, devoted and well meaning parents feel the need to earmark the entire inheritance for the disabled child leaving nothing for the well children.

I understand clients' motivation in this. Many of them feel that since the special needs child is more needy, they desire to give him or her more of a "cushion" than their well children. Fortunately, there is a more rational, scientific and less emotional approach to determining the appropriate funding. This process involves first determining what the special needs child's "supplemental needs" have averaged during recent years, increasing that by inflation and perhaps contingency factors, and determining how much trust principal would produce an annual income equal to that number. The theory is to allow supplemental needs to be met out of the trust income. The principal should be used as a fall-back fund for the beneficiary or, to the extent that it is not necessary for this purpose, to be preserved for ultimate distribution to other family members or charities upon the death of the special needs beneficiary. Generally, after completing this analysis, the parents and their attorneys determine

that the appropriate funding level for the special needs trust ranges from between $75,000-$300,000. For example, at 5% average annual income, $200,000 special needs trust would produce $10,000 in pretax annual income. Depending on the needs of the disabled beneficiary, many parents feel that this would be a sufficient allowance to provide for the beneficiary's amenities.

Be aware, however, that such generalizations concerning the proper level of trust funding are dangerous to the extent that they inhibit the type of analysis described above. Each special needs beneficiary's situation is different both as regards available public assistance and level of supplemental needs. For this reason I caution my clients to be wary of any "conventional wisdom" they may hear concerning this issue.

C. Trust "Dispositive Provisions". This refers to those provisions of the trust dealing with distributions of income and principal to the special needs beneficiary. It is helpful to analyze these provisions on two levels.

1. Distributions During the Special Needs Beneficiary's Lifetime and While He or She Remains Eligible for Public Assistance. The goal here is to limit the trustee's power over income and principal distributions to those which will supplement, and not replace, available sources of public assistance. This is where most mistakes are made in drafting special needs trusts. I believe that because of a lack of understanding of the public assistance eligibility rules, a desire to accommodate the wishes of devoted parents, or both, attorneys often leave loopholes through which social workers can argue that the trust property is a "countable" resource in determining the beneficiary's eligibility for any particular program. This is exactly what the parent wanted to avoid. The problem will often not arise until after the parents' death; therefore, they blithely go along assuming they do not have a problem. There are many ticking time bombs out there. If the trust renders the beneficiary ineligible, not only is the core public assistance program (SSI, Medicaid, SSDI) unavailable, but also locally based programs such as housing whose eligibility requirements bootstrap on SSI criteria. Obviously, such disruptions can be devastating to a sensitive beneficiary who has come to rely on continuity and routine.

To avoid this, the trust must be fully discretionary. That is, the document must commit to the decision whether to distribute income and principal to the third party trustee's "sole and absolute discretion". Also, "precatory language" may express the client's wish (but no direction) that distributions be made only to supplement, and not replace, available public assistance. It is good practice to provide a non-exclusive list of several types of supplemental needs that might be met such as travel, personal care, entertainment, etc. But attempting to get too cute in this

area by using anything other than non-mandatory precatory language can invite a case worker's scrutiny or disqualification.

2. Ultimate Distribution. The trust should include language which causes the trust to terminate if a governmental agency ever concludes that the trust assets are countable, or attempts to reach them in satisfaction of a public assistance lien. This "termination clause" should preserve the beneficiary's continuing eligibility and prevent the trust assets from being spent down to pay for the beneficiary's basic needs which might otherwise be financed through public assistance.

D. Hedging Against Changes in the Law that Might Eliminate the Special Needs Trust Strategy. The termination clause provides one level of protection against future changes in the law aimed at negating special needs trusts. In my opinion, as a practical matter the "special needs trust" should not be an attractive target for reformers because clients who use them are not exploiting a loophole in the public assistance laws or making welfare assistance available to those persons for whom the program was not intended. As the law stands now, no creditor of a trust beneficiary can reach beneficiary's interest in the assets of a fully discretionary trust. This is so because the beneficiary him or herself has no power to compel the trustee to make any distributions. The creditor can stand on no better footing relative to the trust assets than can the beneficiary. A governmental agency providing public assistance is just another creditor of the beneficiary. I do not foresee the law changing to the extent that this time honored, well settled principle will be overruled. Clients often wonder about the government's attack on "Medicaid qualifying trusts". These were trusts established primarily by senior citizens to posture themselves for Medicaid eligibility should they require long term nursing care. They would place their property in these irrevocable trusts from which an independent trustee (perhaps one of their children) had the discretion to make distributions back to them. While these trusts were legal, many welfare reform groups justifiably argued that they violated the spirit of the law: to make welfare assistance available for indigent persons, not the middle class. Congress responded some years ago by eliminating Medicaid qualifying trusts as a public assistance planning tool. Trusts previously created were not "grandfathered" under this legislation. People might ask whether special needs trusts are similarly vulnerable.

I do not think so. Medicaid qualifying trusts are created by people who posture *themselves* for public assistance. Critics of "elder lawyers" who created those trusts argue that such strategies are patently unfair. Creditors' rights laws have always given creditors the ability to reach the assets of such self-created trusts. By contrast, a special needs trust is by definition created by someone other than the beneficiary. That beneficiary is usually an "emancipated" (i.e., adult) child or grandchild of

the trust creator to whom the trust creator owes no continuing legal duty of support under state law. The same unfairness principle applicable to Medicaid qualifying trust simply does not operate here. I would not, therefore, be concerned that Congress or the New Hampshire legislature will extend to special needs trusts the law relating to Medicaid qualifying trusts.