

TRUSTS FOR PUBLIC BENEFITS PLANNING

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I. INTRODUCTION.

For many years trusts have been used for a variety of reasons to obtain goals for a client. Trusts have been an integral part of the planning of estates for tax purposes and for protection against the fear of future generations unwisely spending the family estate on trips to Las Vegas and new cars. Prior to the creation of the Durable Power of Attorney Statute many times trusts provided the only means for individuals to plan for the management of their estates, outside of a Court supervised guardianship, in the event of their incapacity.

This paper is intended to be a primer on the issues and law involved in the use of trusts in public benefits planning. Public benefits exist to provide a safety net to the unfortunate members of our society that due to circumstances beyond their control are unable to provide for their own care and maintenance. Nobody willingly chooses to be a recipient of public benefits. Most clients are forced to depend upon public benefit programs as a result of catastrophic medical or longterm care expenses. The limited existence that these programs provide have created a need to protect funds for the recipient of public benefits that can be used to improve the quality of their life or of their dependants.

Trusts can be an effective tool in the overall plan of an individual client when that client is faced with a situation wherein due to some illness or disease the client knows that he or she will in the future, be unable to continue the care and support of a dependant. The client may be a parent of a disabled adult or child that is dependant upon them for support or care. The client may be concerned that their spouse will be left destitute when they are no longer able to work and provide for them.

The attorney actively involved in the practice of Elder Law or Estate Planning will continually receive requests to draft trusts that will enable a client to qualify for public benefits while maintaining the estate of the applicant for the use and benefit of others such as spouses and disabled dependants.

Many times the client diagnosed with a chronic debilitating disease knows that they will one day be dependant upon public benefits for their care and maintenance. They may be concerned with the preservation and use of some part their estate to improve the quality of their life.

Additionally, an attorney knowledgeable about public benefits planning may be called upon to assist litigation attorneys as they attempt to provide some method to their client to maintain the proceeds from personal injury suits in the face of staggering medical care costs. Many times the medical expenses incurred by a plaintiff in a tort suit will cause the person to exhaust all of their personal resources and force the person to seek public benefits such as Medicaid to help pay for their medical treatment. During the pendency of the litigation all costs of treatment will be covered by the Medicaid program. Upon the receipt of the settlement/award the client will lose eligibility for Medicaid and the proceeds from the settlement may be quickly dissipated on the huge medical expenses the client must now confront. The original idea for this paper was the

result of an article written by Clifton B. Kruse "Trust Protection of Personal Injury Recoveries from Public Creditors" in the November 1990 issue of The Colorado Lawyer Vol. 19, No. 11. This article written by one of the preeminent attorneys in the field succinctly makes the case for the use of trust in this manner.

II. SSI Eligibility "The Key"

In the scenarios set forth above the ultimate goal of the planning will be to provide some benefits either money or other types of support to the beneficiary while maintaining eligibility for Medicaid directly or by qualifying for Supplemental Security Income benefits. The Supplemental Security Income (SSI) program was passed as an amendment to the Social Security Act in 1972. Social Security Act, Title XVI, 42 U.S.C. secs. 1381-1383d (1983 and Supp. 1991); codified at 20 C.F.R. secs. 416.101-2227. It is a cash grant program but the limited benefits of the SSI program are not the true focus of obtaining SSI eligibility for the client. SSI is a key to the more important benefits of the Medicaid program. Texas is one of 31 states known as "1634" states. This is the section of the Social Security Act that authorizes Texas to provide Medicaid eligibility to any recipient of SSI benefits. 42 U.S.C. sec. 1383c. A disabled person qualifying for SSI is said to be a "categorically needy" person and as such automatically qualifies for Medicaid benefits in the community. The determination of eligibility for SSI is made by the Social Security Administration and upon receiving eligibility for SSI the applicant is likewise eligible for Medicaid. Conversely, loss of SSI benefits will result in the loss of Medicaid benefits. In order to qualify for SSI an individual must be disabled, their income cannot exceed \$552.00 a month in 2003 and their countable assets cannot exceed \$2,000.00. The goal in the use of a trust is to render the assets of the trust uncountable for eligibility purposes but to still allow the use of the assets to benefit the Medicaid recipient. The eligibility for Medicaid is granted regardless of the amount of SSI benefit the person is receiving. This particular part of the rules governing eligibility is extremely important in the planning for the supplemental needs of SSI/Medicaid recipients and will be further explored in the following parts of this paper. The important thing to remember is that to obtain the needed result for the client you must be able to qualify for SSI and maintain eligibility. Your benefits under SSI can be reduced if there are any increases in your income during a month of eligibility. However, if you qualify for \$1.00 of SSI in a month you are fully eligible for Medicaid benefits for that month.

The Medicaid benefits received as a result of eligibility for SSI are called "Community Medicaid" or Medical Assistance Only (MAO). Persons residing in nursing homes can be eligible for "Nursing Home Medicaid" although their income exceeds the income limitations of the SSI program. There are other eligibility restrictions in Texas for persons applying for Medicaid Nursing Home benefits; 42 U.S.C. sec. 1396a (a)10 (A) (ii) (V); V.A.T.C., Human Resources Code sec. 32.024 (f) & (g)(1992) and waiver home based services; 42 U.S.C. sec. 1396a(10)(A)(ii)(VI);42 C.F.R. sec. 435.217 (1991); V.A.T.C., Human Resources Code sec. 32.024(h)(1991). The income and resource standards are required to be identical for these programs.¹

III. TRANSFER PENALTIES

On December 14, 1999 President Clinton signed into law the Foster Care Independence Act of 1999 (H.R. 3443) Public Law 106-169. This bill adopts the penalties for uncompensated transfers of resources that has existed in the Medicaid long term care program since enactment of the OBRA 1993 law.

Prior to this date a person could give away all of their money or voluntarily become destitute and qualify for SSI benefits the first day of the next month, if they met the other eligibility criteria. Very few people would want to volunteer to become poverty stricken but it was a very important, life saving move for some individuals. If you had modest means but were unable to obtain Medical insurance because of a preexisting illness or injury and you were unable to pay the cost of your medical care and unable to qualify for Medicare then this may have been the only avenue available for you to seek medical care. As of December 14th, 1999 this is no longer possible as a means of accessing healthcare. The new law would impose a penalty for the uncompensated transfer of assets and deny eligibility for up to 36 months.

If an individual or the spouse of an individual disposes of resources for less than fair market value within 36 months of applying for SSI benefits then the individual is ineligible for SSI benefits for a period of time equal to the value of the transferred resources divided by the maximum monthly benefit (\$552.00 in 2003). The penalty is capped at 36 months. Under the new law if someone voluntarily gifts their assets away they would not be eligible until the penalty time has past. If a person were to refuse a settlement the refusal would result in a period of ineligibility as the refusal would be viewed as a constructive receipt of the proceeds and then an uncompensated transfer. If they were receiving Medicaid as a result of their SSI eligibility (piggy back type) then they would lose their Medicaid eligibility as well.

The impact of the transfer penalty provisions is the driving force behind the use of SNT's to protect assets of beneficiaries and at the same time allow the assets to provide benefits for the person. Prior to the passage of the transfer penalty rules a person could just give the assets recovered in a tort settlement or from an inheritance to their parents, other relative or friend and the assets would not be a countable resource for eligibility purposes. They could have placed the assets in an irrevocable trust that they were the beneficiary of, but that they could not force distributions of the corpus for their benefit. The gifting away of the assets would likewise not have jeopardized their benefits. That is no longer the case. Under current law a person cannot place their asset in a trust and make them unavailable without incurring the transfer penalty.

Another significant feature of the law is found in **SEC. 205. TREATMENT OF ASSETS HELD IN TRUST UNDER THE SSI PROGRAM.** Section 1613 of the Social Security Act (42 U.S.C. 1382b) was amended to make certain trusts a "countable resource."

Under the prior law unless a beneficiary could revoke a trust or otherwise compel distributions for their use the assets in the trust were not counted against them as an asset. Under the new law if the trust is a revocable trust established by an individual, the corpus of the trust will be considered an available resource to the individual. In the case of an irrevocable trust established by an individual, if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual (or of the individual's spouse), the portion of the corpus from which payment to or for the benefit of the individual (or of the individual's spouse) could be made will be considered an available resource and if over the asset limit disqualify the person from receiving benefits. The new law applies to a trust without regard to:

- (i) the purposes for which the trust is established;
 - (ii) whether the trustees have or exercise any discretion under the trust;
 - (iii) any restrictions on when or whether distributions may be made from the trust;
- or
- (iv) any restrictions on the use of distributions from the trust.

The new law basically adopts the provisions of the OBRA 1993 law concerning penalizing transfers of resources to obtain long term Medicaid benefits and the OBRA 1993 provisions concerning the treatment of assets held in trust. One difference between the Medicaid provisions and the new SSI penalty is that a penalty for a transfer under the Medicaid provisions is unlimited whereas the penalty applying to SSI eligibility is limited in duration to 36 months. There are exceptions to the penalty for transfers that are the same as the exceptions to the penalty provisions in the Medicaid rules such as:

- (i) the resources are a home and title to the home was transferred to--
 - (I) the spouse of the transferor;
 - (II) a child of the transferor who has not attained 21 years of age, or is blind or disabled;
 - (III) a sibling of the transferor who has an equity interest in such home and who was residing in the transferor's home for a period of at least 1 year immediately before the date the transferor becomes an institutionalized individual; or
 - (IV) a son or daughter of the transferor who was residing in the transferor's home for a period of at least 2 years immediately before the date the transferor becomes an institutionalized individual, and who provided care to the transferor which permitted the transferor to reside at home rather than in such an institution or facility;
- (ii) the resources--
 - (I) were transferred to the transferor's spouse or to another for the sole benefit of the transferor's spouse;
 - (II) were transferred from the transferor's spouse to another for the sole benefit of the transferor's spouse;

(III) were transferred to, or to a trust (including a trust described in section 1917(d)(4)) established solely for the benefit of, the transferor's child who is blind or disabled; or (IV) were transferred to a trust (including a trust described in section 1917(d)(4)) established solely for the benefit of an individual who has not attained 65 years of age and who is disabled.

The trust referenced in the prior paragraph is what is commonly known as a Supplemental Needs Trust or a Special Needs Trust sometimes referred to as a "d4a" trust.

IV. MEDICAID QUALIFYING TRUSTS (MQT)

Many elderly people were concerned with paying for the costs of care in a nursing home if they became ill and needed long term care. These individuals had no need for Medicaid benefits prior to entering the nursing home because they were covered by Medicare or private insurance for their acute medical costs. None of these programs cover long term care costs. Medicaid was and still is the only program that would help with longterm care expenses. In an effort to qualify clients for Medicaid Nursing Home benefits lawyers began to recommend the use of irrevocable, discretionary, grantor trusts.²

These types of trust worked great for the purpose intended and were called Medicaid Qualifying Trust (MQT). A typical MQT would be an irrevocable, grantor trust. It would allow the Trustee to pay to the grantor/beneficiary any amount of income he or she deemed necessary, with full authority to withhold any or all of the income from the beneficiary at the Trustee's discretion. The Trustee would be restricted from invading the corpus of the trust for the benefit of the beneficiary. This would in turn drop the applicant below the resource limit of \$2000.00 for receiving Medicaid. Under the regulations of the SSI program, restricting access to the principal would render the corpus an unavailable resource. The SSI federal regulations that determine if an asset is an available resource state:

"If the individual has the right, authority or power to liquidate the property, or his or her share of the property, it is considered a resource. If the property rights cannot be liquidated, the property will not be considered a resource of the individual." 20 C.F.R. part 416.1201(a)(1).

Typically this trust was created prior to the individual entering a nursing home. During the time between the settling of the trust and entering the nursing home the trustee would pay the income of the trust to the beneficiary. Upon entry into the nursing home the Trustee would exercise discretion and withhold any income from the beneficiary. This would reduce the applicant's income below the income limit for SSI eligibility and the person would be eligible for SSI and hence Medicaid Nursing Home benefits.

The client was able to enjoy the income from the assets until such time as they were institutionalized, all the while knowing that the principal of the trust was safe because it would not be considered an "available resource" under the SSI regs or for Medicaid purposes.

In response to allegations that wealthy individuals were using Medicaid Qualifying Trusts to shelter assets while qualifying for Medicaid Nursing Home benefits Congress amended Section 1902 of the Social Security Act. The amendment added a sec (k) to 42 U.S.C. 1396a that took effect on June 1, 1986.

- (k) (1) **[SSA 1902(k)]** In the case of medicaid qualifying trust (described in paragraph (2), the amounts from the trust deemed available to a grantor, for purposes of subsection (a)(17) of this section, is the maximum amount of payments that may be permitted under the terms of the trust to be distributed to the grantor, assuming the full exercise of discretion by the trustee or trustees for the distribution of the maximum amount to the grantor. For purposes of the previous sentence, the term "grantor" means the individual referred to in paragraph (2).
- (2) For purposes of this subsection, a "medicaid qualifying trust" is a trust, or similar legal device, established (other than by will) by an individual (or an individual's spouse) under which the individual may be the beneficiary of all or part of the payments from the trust and the distribution of such payments is determined by one or more trustees who are permitted to exercise any discretion with respect to the distribution to the individual.
- (3) This subsection shall apply without regard to--
- (A) whether or not the medicaid qualifying trust is irrevocable or is established for purposes other than to enable a grantor to qualify for medical assistance under this subchapter; or
- (B) whether or not the discretion described in paragraph (2) is actually exercised.
- (4) The State may waive the application of this subsection with respect to an individual where the State determines that such application would work an undue hardship.

Texas has included the Medicaid Qualifying Trust language in its Medicaid Eligibility Handbook at section 2313.3. It is interesting to note that Texas has expanded the language to include a trust established by the client, his spouse, guardian, or anyone holding his power of attorney. (See exhibit A attached.) The Centers for Medicaid and Medicare Services believes that the plain language of the MQT statute referring to "spouse" actually means guardians, legal representative, or court acting in the role of guardian for an individual. That is quite a stretch of the meaning of the word "spouse". it is difficult to envision such an expansionist reading of the Federal law. These exhibits are included to illustrate the point that the drafting and funding of these trusts cannot be a "form type" practice. The laws and regulations governing these trusts are continually

being revised and the attorney drafting these instruments must keep abreast of the current law and proposed changes.

The Medicaid Qualifying Trust Statute effectively voided all trusts that had sought to use the discretionary authority of a Trustee to pay income to a person until they became institutionalized and then stop the income and thereby qualify them for Medicaid Nursing Home benefits. Under the statute the maximum amount of income the trustee could distribute was treated as if it had been given to the beneficiary whether or not the money was paid by the trustee.

A careful reading of the statute would disclose that there is an easy way to prevent the trust from being considered an MQT. If the Trustee were directed to pay all of the income from the trust to the beneficiary without discretion then the statute would not apply. The resources (principal) would be safe from consideration as an available resource, the client would enjoy the income from the trust while they were healthy and upon institutionalization the income from the trust would go to the nursing home. The income would be lost during the stay of the client in the nursing home but if the person were to go home at a later date the income would again be available to them for their use. This non-discretionary trust method is currently being used in many states today.³ However, the use of such a nondiscretionary would bring about another problem. The transfer of the assets to the trust would bring about a penalty period of up to 36 months before the client could qualify for benefits. Section 1917(c) of the Social Security Act. 42 U.S.C. Section 1396p(c)(1) During the 36 month period the client would lose SSI and Medicaid benefits. The cost of paying for medical care during the penalty period may eat up a considerable amount of the settlement or inheritance of the beneficiary.

V. SUPPLEMENTAL NEEDS TRUSTS

A. Drafting the Supplemental Needs Trust

As discussed in the previous sections above the goal of the Supplemental Needs Trust would be similar to that of a Medicaid Qualifying Trust. The corpus of the trust must not be considered an available resource so that the beneficiary will satisfy the asset limitations of programs such as SSI and Medicaid. Additionally, the trust must allow for the expenditure of funds for the benefit of the beneficiary without running afoul of the income limitations of such programs. Both of these issues present their own unique challenges to the draftsman in the creation of the trust. The income issues provide an ongoing challenge that must be dealt with during the useful life of the trust.

The drafting techniques that can be utilized to make the SNT viable as an entity that can both protect the assets of the beneficiary from being a countable resource while providing benefits or disbursements to the beneficiary that are meaningful and contribute to the quality of life of the beneficiary are complex and require a thorough understanding of the eligibility requirements of the programs that the beneficiary may

now be qualified for or will seek to obtain in the future. **Anyone attempting to draft such a trust should have experience and knowledge of the public benefits program requirements from which a trust beneficiary may seek to eligibility.**

B. Parents for Children

In counseling Elder Law clients the attorney will often find that the client is not concerned with the issue of how their care will be paid for but many times the primary concern of the client is the care and maintenance of a disabled child. Sometimes, the elderly client will have spent their entire adult life taking care of the needs and providing for a child or loved one that is disabled and totally dependant upon them. The emotional trauma that the elderly person experiences is tremendous as they worry how this disabled person will cope with economic and social problems without their help. The elderly client may be faced with the potentially disabling effects of some catastrophic disease or illness but their most pressing concern will be how can I provide for my child once my health fails.

In these cases a Supplemental Needs Trust or a Fully Discretionary Trust is often an excellent device to accomplish the goals of the client. Most often because of the inability to obtain employment the disabled child will already be a recipient of SSI benefits and hence Medicaid. Often the disability will be such that the child may need extensive and costly medical treatment. Maintaining eligibility for the Medicaid benefits to cover these medical cost will be of utmost importance. The monies available to the parent to provide for the care and welfare of the child may be of modest amounts and would only provide for payment of the medical expenses for a short time. A Supplemental Needs Trust or a Fully Discretionary Trust will allow the parent to enhance the quality of the child's life. The use of such a trust can provide monies to be spent on things that the public benefit programs will not provide as well as preserving Medicaid eligibility so that the money is not consumed by expensive medical care

C. Creation and Funding of Trusts To Protect Inheritance

As the statutes set forth above show if the trust is created with the assets of someone other than the beneficiary, or their spouse, then none of the problems with transfer penalties or MQT status apply. If a parent or someone else creates and funds the trust with money or assets that do not belong to the applicant the trust will not be considered an MQT. In establishing a testamentary trust or inter vivos trust for a disabled child a parent need not be concerned about MQT status. A parent can create an inter vivos or testamentary trust and fund it in any manner they desire with no effect on the eligibility of the beneficiary. The only impact from such a trust will be when disbursements are made to the beneficiary. The disbursements from the trust may be counted as income to the beneficiary and reduce or eliminate SSI eligibility if the income of the beneficiary exceeds the SSI limits.

In this type of trust the corpus must be rendered an "unavailable resource". In order to prevent the corpus of the trust from being considered an "available resource" we need

only restrict access to the funds as set forth in Section IV above. 20 C.F.R. part 416.1201(a)(1). Trust assets are a resource if the individual has access to the trust assets, or can direct the use of the assets, or can terminate the trust and use the trust assets for their support and maintenance. POMS SI 01120.200(D) (1). **Once the corpus is unavailable then the asset requirements of both the SSI and Medicaid program will be met.**

As long as the corpus is rendered unavailable and the beneficiary cannot force a distribution for their benefit then the resource rule will be met and **only the actual disbursements from the trust will be evaluated as income under the rules of the program.**

D. Preservation of Assets from Personal Injury Suits

In other cases a Supplemental Needs Trust may be used as a vehicle to preserve a recovery in a personal injury setting when the monies recovered would be rapidly depleted by huge medical expenses. If eligibility for public benefits can be maintained and the monies used to provide for things that these programs are unable to supply then improvements in the quality of life of a severely injured person is possible. It must be kept in mind the importance of continuing the SSI/Medicaid eligibility for a disabled plaintiff. Even if the money from the settlement would allow the person to afford private health insurance they will most likely be uninsurable at any cost. Unless the person can qualify for Medicare then Medicaid may be the only way of obtaining coverage for health care expenses that would otherwise quickly consume the monies they received for pain and suffering or lost wages. These types of SNT's are often referred to as Litigation Special Needs Trust or Litigation Supplemental Needs Trusts to distinguish them from SNT's set up in other context.⁴

The MQT rules would prevent the use of SNT's because they are established with the assets or resources of the beneficiary except for the safe harbor provisions contained in the law. The law allowing the creation of a SNT with the proceeds from a personal injury settlement is found at 42 USC 1396p(d)(4)(A). Basically, this section of the law exempts certain trust from the MQT provisions. A trust set up to comply with this section will not be considered an available resource and the placing of the assets into the trust will not cause the beneficiary to be hit with a penalty for transferring the assets into the trust. The requirements of the law are fairly simple on their face and the Federal Law has been set forth in the Texas Medicaid Eligibility Handbook at § 2313.45 entitled Exception Trusts:

15.417(f) — The Omnibus Budget Reconciliation Act of 1993 identifies three types of trusts which are exceptions to the trust provisions stated in [Items 2313.41 through 2313.44]. These exceptions apply only to trusts established on or after August 11, 1993.

§15.417(f)(1) — Special needs trust.

Description: A special needs trust is a revocable or irrevocable trust established with the assets of a client under age 65 who meets the Supplemental Security Income (SSI) program's disability criteria. The trust must be established for the client's benefit by his parent, grandparent, legal guardian, or a court. The trust must include a provision that the state is designated as the residuary beneficiary to receive, at the client's death, funds remaining in the trust equal to the total amount of Medicaid paid on his behalf. This trust exception continues even after a client becomes age 65 if he continues to meet the disability criteria for the SSI program. However, additions or augmentations to the trust after the client becomes age 65 are a transfer of assets.

§15.417(f)(1) — Treatment as Resource: The trust is not counted as a resource.

Treatment as Income: Any distribution to or for the benefit of the client from corpus or income generated by the trust, except payments for medical and social services, is countable income. [See Item 2420, Income Exemptions, for an explanation of medical and social services.] A payment to or for the benefit of the client is counted under trust provisions only if such payment is ordinarily counted as income.

Transfer of Assets: Transfer-of-assets provisions do not apply when such a trust is established. However, if assets are transferred to another party from the corpus or income generated by the corpus, then the policy in [Item 2320, Transfer of Assets] applies. See Exhibit B attached.

If the requirements of § d4A are met then the MQT rules do not apply and the assets of the trust will not be considered and available asset for eligibility purposes and the transfer of the money into the trust will not incur a penalty.

E. Texas Specific Issues

Most of the issues discussed in this paper so far are issues that are written about by legal commentators through the United States. There are many Elder Law practice manuals that discuss these issues in great detail and offer excellent advice on the Federal law in this area. The problem facing a draftsman of these type of trusts is that there are several quirks to the law that apply when using these types of trusts in Texas. The first difference in creating these trusts in Texas deals with the law allowing Texas Courts to create trusts and the second problem deals with funding of such trusts with a settlement or recovery that includes a structured settlement.

1. Court Created d4A trust

There are only 2 statutes that authorize Texas Courts to create trusts. One is § 142.005 Trust for Property. This statute applies when a lawsuit has been filed in the District Court and the suit involves an "incapacitated

person” as defined in § 142.007 and if a minor, no legal guardian has been appointed. Additionally, the trustee must be a trust company or a state or national bank having trust powers in the state. § 142.005 (a). Upon a showing that it is in the best interest of the minor or incapacitated person the trust may contain provisions necessary to establish a special needs trust under 42 U.S.C. § 1396p(d)(4)(A). § 142.005(g). The specific requirement that the trustee be a corporate entity is not the rule in the majority of U.S. jurisdictions.

The second statute that allows for a Texas Court to create a trust for a beneficiary is found at § 867 of the Texas Probate Code entitled Creation of a Management Trust. Under this statute a Court may create a trust if a guardianship of the person or estate of the beneficiary is in existence. The § 142.005 set forth above specifically excludes situations where there is a legal guardian appointed. This statute also allows the Court upon a finding it is in the best interest of the ward and that it is necessary and appropriate for the ward to be able to receive public benefits to put specific provisions in the trust to allow the trust to comply with the eligibility requirements of state or federal programs. This §867 also allows for the appointment of a noncorporate fiduciary or trustee if no financial institution is willing to serve as trustee and it is in the best interest of the ward. At § 868(5) the law specifies that the compensation of the trustee shall be determined in the same manner as the compensation of a guardian under §665 of the Probate Code. This has been a point of contention with some banks and trust companies as they prefer to be paid under their usual fee schedules.

2. Funding SNT's with Structured Settlements

In most lawsuits settled today the compensation to be paid to the plaintiff will often include a structure. Structures can be very complex or simple in their terms. The standard structure, if there is such thing, would typically include a cash payment to the plaintiff and the purchase of an annuity by the defendant that will pay the plaintiff additional funds in the future. The terms of the annuity is the point where structures can become very complex entities. If a child is involved the terms may withhold any payments until the child reaches the age of majority as the parents are required by law to provide for the child's needs. The annuity may anticipate changing conditions that will come about during the life of the plaintiff and provide for cash payments in lump sums at different intervals. In many cases the annuity is designed with the help of a life care plan that is created by doctors, therapists and other professionals that can predict the special medical care or educational needs of the plaintiff. The annuity make take into consideration the needs of the plaintiff's family and dependents and continue to pay benefits long after the death of the

plaintiff. **The use of annuities to fund these structures can cause loss of public benefits in Texas if the annuity does not comply with specific rules promulgated by the Texas Department of Human Services.** If a SNT is used in an attempt to prevent the plaintiff from losing eligibility and an annuity is made payable to the trustee of the trust then the annuity must still meet the requirements of the Texas Medicaid eligibility rules. The specific rules governing how the Texas Medicaid program evaluates annuities are found in the Texas Medicaid Eligibility Handbook at §2342.8. The rules are reprinted as exhibit C attached to this paper. The rules have very specific interpretations by the DHS. For instance most readers would believe that an annuity that is payable for the life of the applicant would comply with the section of the rules that mandate that the annuity:

pay out principal and interest **in equal monthly installments** to the client in sufficient amounts that the principal is paid out during the life expectancy of the client, [using the life expectancy tables in Appendix IX]

However, the Department has taken the position that unless a specific term of years that is less than or equal to the life expectancy (as found on their tables) is used the annuity does not comply with the rule.

The difficult part of this process is that many times the terms of the annuity are worked out by the settling attorney at the time the lawsuit is settled. The attorney drafting the SNT may not be brought into the case until after all of these issues are supposedly settled. The author has been involved with several cases where the entire settlement had to be renegotiated because once the annuity was deemed to be disqualifying it had to be totally rewritten which means that the client's consent to the terms of the settlement must be obtained again as well. The other trap for the unwary lies in using out of state structured settlement companies. Many of these companies operate nationwide and bring great experience and knowledge to these situations. But most companies are not aware of the specific requirements of the Texas rules.

These issues that are specific to Texas and the public benefits programs we have in our state only reinforce the need for the draftsman of the SNT to have experience in obtaining benefits for the types of clients that the SNT is designed to benefit.

VI. ADMINISTRATION OF THE SUPPLEMENTAL NEEDS TRUST

Once the trust is established and benefit eligibility obtained you must still deal with the

practical problem of how to disburse income from the trust and still maintain eligibility for SSI benefits. SSI beneficiaries are subject to strict reporting requirements that require any income or property received by the recipient to be reported by the 10th day of the month following the month of receipt. Likewise, in-kind support (non-cash contributions) must be reported as well.⁵ If the income is spent in the month it is received then only income limit rules apply. If the countable income is not spent in the month of receipt then the following month it is considered to be a resource. POMS SI 00810.010. This distinction is critical to the administration of the trust. If the resource/asset limit of \$2,000.00 is exceeded by \$1.00 then the eligibility for SSI and the Medicaid card is lost for the entire month. Any receipt of income in the month will reduce the entitlement for that month based on the value of the cash or in-kind support.⁶ If the countable income is large enough it can reduce the SSI benefit to zero and also cause loss of Medicaid benefits for that month.

A. Trustee's Goal

The goal of the trustee is to make disbursements from the trust that will improve the quality of life of the beneficiary but not disqualify he or she for SSI or Medicaid. With an understanding of the SSI rules governing what is considered "countable income" and what is not, the trustee can make distributions that fulfill this goal. When someone makes payments for the beneficiary to a vendor for goods other than food, clothing, or shelter, the payments will not be considered income to the beneficiary.⁷ The list of items that can be furnished to the beneficiary is limited only by the trustee's knowledge of the SSI regulations and imagination. Examples of such items are: experimental drug therapies, additional physical therapies, special clothing, airline tickets for out of state relatives, a whirlpool, a private room, a VCR, a private duty nurse, vacations, paid companions to accompany them on vacations, a computer and so on.⁸

The rules for treatment of income by SSI make distinctions between cash or in-kind income. In-kind income is not cash but is food, clothing or shelter or something you can use to obtain food, clothing or shelter. The in-kind category is further divided into in-kind support and maintenance (ISM) and other unearned income. The general rule is that SSI benefits will be reduced if the beneficiary is not paying the full cost of his or her food clothing or shelter.⁹ The ISM is valued by one of two methods. POMS SI 00835.001. The one-third reduction rule (VTR) and the Presumed Maximum Value Rule (PMV) are used to determine how a given amount of ISM will effect the benefits of the recipient during the month in which the ISM is received. Analysis of these rules is not possible in this paper but the trustee must have a clear understanding of these rules so that only disbursements for things that will not result in a loss of SSI or Medicaid benefits will be made. If these rules are considered the trustee can provide for many supplemental needs that will enhance the quality of life of the beneficiary while maintaining eligibility for public benefits.

In addition to the reporting requirements mentioned above the administration of the trust requires careful record keeping so that all disbursements can be documented. All

distributions from the trust will be reported as "income" to the IRS by way of a K-1. Local public benefits administrators may run a cross match with the IRS computer and demand that all income attributable to the beneficiary's Social Security number be explained. This demand may take place years after the date the distributions were made so strict record keeping must be done by the trustee.¹⁰

VII. SUMMARY

The use of a Supplemental Needs Trust is not appropriate in all instances. Before recommending such a device the attorney must evaluate many factors. The amount of the corpus of the trust is one item. The family situation of the beneficiary and the future caretakers available to he or she is an important consideration. The desire of the beneficiary concerning their living arrangements such as their desire to live in the community or in some form of sheltered living arrangement must be considered. The expenses a Trustee will incur for professional fees for accountants and legal fees for attorney assistance in administration of the trust.

In situations where the use of such a trust would enable an otherwise bedridden, disabled or incapacitated person to have the chance for companionship, travel, or entertainment its efficacy cannot be overemphasized. Consider the plight of a disabled person surviving on SSI payments alone. Any additional funds that would pay for a trip to the zoo or a computer with a modem that would allow them to communicate with the rest of society could make an unbelievable difference in the quality of their life.

A Supplemental Needs Trust can be the means to provide for those additional funds. There are many problems and difficulties in drafting and maintaining such a trust and the potential for legal and regulatory changes affecting them is always a possibility. With skillful drafting and a thorough knowledge of the rules of the public benefit programs Elder Law attorneys can assist both our brethren of the bar and our own clients in preserving inheritances and tort recoveries while maintaining the medical benefits necessary for their well being.

Medicaid Eligibility Handbook

2313.3 Medicaid-Qualifying Trust

§15.100 — A Medicaid-qualifying trust (MQT) is one that the client, his spouse, guardian, or anyone holding his power of attorney establishes using the client's money. The client is the beneficiary of a Medicaid-qualifying trust. A Medicaid-qualifying trust is one that was established between June 1, 1986, and August 10, 1993. Trusts which meet the MQT definition and were established prior to June 1, 1986, are treated as standard inter vivos trusts.

Note: Public Law 103-66 (OBRA '93) revised policy for trusts established using the client's money on or after August 11, 1993. (See Item 2313.4, Trusts (August 11, 1993 and After)). For Medicaid-qualifying trusts established before that date, continue using the policy in this section. If provisions for a change in the trust were included in the document before August 11, 1993, use the policy governing Medicaid-qualifying trusts for the change. If the trust was amended on or after August 11, 1993, apply the policy in Item 2313.4 to the change.

§15.415(h)(1) — Public Law 99-272 states that distributions from Medicaid-qualifying trusts are considered available to the client whether or not distributions are actually made. The amount available is the maximum amount the trustee could disburse if he used his full discretion under terms of the trust. If distribution is not made, the maximum amount the trustee may distribute if he used his full discretion under terms of the trust is considered an available resource. If trusts do not specify an amount for distribution, and if the trustee has access to and use of the principal or the income from the trust, then the entire amount is considered an available resource that may be used for the client's benefit.

References: If distribution is made, see Item 2453.91, Income from Medicaid-Qualifying Trusts.

Examples

The trustee has the discretion to distribute the corpus of the trust, which is property worth \$6,000. The corpus, therefore, is a \$6,000 countable resource.

The client established an irrevocable Medicaid-qualifying trust before August 11, 1993. The trustee has discretion only to distribute \$100 monthly from the income earned by the trust but chooses not to do so. The corpus is not a countable resource; however, the client's other countable resources are increased by \$100 every month. If necessary, schedule a special review to monitor eligibility.

Exhibit A 2313.3 Medicaid-Qualifying Trust

Medicaid Eligibility Handbook

2313.45 Exception Trusts

§15.417(f) — The Omnibus Budget Reconciliation Act of 1993 identifies three types of trusts which are exceptions to the trust provisions stated in [Items 2313.41 through 2313.44]. These exceptions apply only to trusts established on or after August 11, 1993.

§15.417(f)(1) — Special needs trust.

Description: A special needs trust is a revocable or irrevocable trust established with the assets of a client under age 65 who meets the Supplemental Security Income (SSI) program's disability criteria. The trust must be established for the client's benefit by his parent, grandparent, legal guardian, or a court. The trust must include a provision that the state is designated as the residuary beneficiary to receive, at the client's death, funds remaining in the trust equal to the total amount of Medicaid paid on his behalf. [Use Form 1210, Subrogation (Trusts/Annuities/Court Settlements), to report to the Provider Claims Payment Section any potential paybacks to the state as the residuary beneficiary of special needs trusts.] This trust exception continues even after a client becomes age 65 if he continues to meet the disability criteria for the SSI program. However, additions or augmentations to the trust after the client becomes age 65 are a transfer of assets. [See Item 2320, Transfer of Assets.]

If a client is not receiving Social Security, SSI, or Railroad Retirement disability benefits, a disability determination must be done. (See Item 2214, Determining Blindness or Disability.)

§15.417(f)(1) — Treatment as Resource: The trust is not counted as a resource.

Treatment as Income: Any distribution to or for the benefit of the client from corpus or income generated by the trust, except payments for medical and social services, is countable income. [See Item 2420, Income Exemptions, for an explanation of medical and social services.] A payment to or for the benefit of the client is counted under trust provisions only if such payment is ordinarily counted as income.

Transfer of Assets: Transfer-of-assets provisions do not apply when such a trust is established. However, if assets are transferred to another party from the corpus or income generated by the corpus, then the policy in [Item 2320, Transfer of Assets] applies.

Exhibit B 2313.3 Medicaid-Qualifying Trust

Medicaid Eligibility Handbook

2342.8 Annuities

§15.442(g)(1) — A revocable annuity is a countable resource. An irrevocable annuity is a transfer of assets if it does not back the principal (original purchase price) to the client during his life expectancy. To qualify for exemption from transfer of assets rules, an annuity must be issued by an insurance company licensed and approved to do business in the State of Texas. The eligibility specialist must review the terms of an annuity contract or agreement to determine if the principal of the annuity is an available resource or considered a transfer of assets.

Note: The eligibility specialist should refer the annuity document to the regional attorney if there is a question whether or not the annuity is revocable.

§15.442(g)(2) — To avoid a transfer of assets penalty, an annuity purchased by or for the client must:

- (1) be irrevocable,
- (2) pay out principal and interest in equal monthly installments to the client in sufficient amounts that the principal is paid out during the life expectancy of the client, [using the life expectancy tables in Appendix IX], and
- (3) name the State of Texas, Texas Department of Human Services, or its successor agency as the residual beneficiary of funds remaining in the annuity, not to exceed any Medicaid funds expended on the client during his lifetime. [Use Form 1210, Subrogation (Trusts/Annuities/Court Settlements), to report to the Provider Claims Payment Section any potential paybacks to the state as the residuary beneficiary of irrevocable annuities.]

§15.442(g)(3) — The average number of years of expected life remaining for the client must equal or exceed the stated life of the annuity. If the client is not reasonably expected to live longer than the guarantee period of the annuity, the client will not receive fair market value for the annuity based on projected returns. In this case, the annuity is not actuarially sound and a transfer of assets for less than fair market value of the premium has taken place to the extent of the portion not anticipated to be repaid in the client's lifetime. The penalty is assessed based on a transfer of assets that is considered to have occurred at the time the annuity was purchased, minus any principal paid to the client prior to the file date for Medicaid benefits.

Example: Carla Carter, age 70, purchased a \$50,000 paid-up irrevocable annuity in November 1996. Terms of the annuity contract provide for payments of \$250 per month beginning January 1, 1997. The payments are for principal and interest. Appendix IX indicates that a 70 year old female has 15.07 years of expected remaining life. Therefore, the actuarial value of the annuity is \$45,210.00.

$$\$250 \times 12 \text{ month} = \$3,000 \times 15.07 \text{ years} = \$45,210.00$$

The actuarial value of this contract (\$45,210.00) does not equal the purchase price (\$50,000.00). Therefore, Ms. Carter transferred the entire purchase price of \$50,000.00 in November 1996.

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Exhibit C 2342.8 Annuities

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5. Prensky and Tobin, Using the Special Needs Trust, 1992 NELA Symposium Manual at page 10
6. Id. at 11.
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8. Haines and Combs, Hot to Settle a Personal Injury Claim for a Plaintiff on Medicaid, NELA Quarterly Vol. IV. No. III, Summer 1992.
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