

SPECIAL NEEDS TRUSTS AND TRUST PROTECTORS

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Creation

A. Types of Special Needs Trusts (SNT).

1. Self-settled or first party special needs trusts are created with the individual's own money. The funds often come from personal injury settlements, inheritances or other similar lump sum sources. These trusts are always irrevocable and surprisingly, the Grantor is not the individual who owns the money.

2. Third party special needs trusts are established by someone other than the beneficiary of the trust. The money used to fund this type of trust belongs to that third party. These trusts are most often testamentary or revocable inter vivos in nature. The Grantor is usually, but not always and not necessarily, related to the beneficiary.

3. Pooled Special Needs Trusts have a nonprofit association as the trustee. The funds come from the beneficiary or a third party with sub-accounts established for each beneficiary. A Master Trust is established and individuals execute a joinder agreement.

B. When is a Special Needs Trust Appropriate?

1. Special Needs Trust is only appropriate for a disabled individual who is under the age of 65 years. The individual for whom the trust is established must be disabled as defined in the Social Security Act at 42 USC §1382c(a)(3)(A).

2. A Special Needs Trust is appropriate when an individual has no or inadequate health insurance coverage.

3. A Special Needs Trust is appropriate when a beneficiary or family members or friends of a beneficiary want to supplement benefits not otherwise provided by government entitlements.

C. Basic Concepts

1. The Omnibus Reconciliation Act of 1993 (OBRA 93 or the Act) created the framework for Special Needs Trusts. The Act provides that the funding of these trusts are exempt from the *transfer of asset* rules. This exemption remains in place even though the Deficit

Reduction Act of 2005 (DRA 05) drastically modified the transfer of asset rules.

2. The Act allows a quid pro quo to the disabled beneficiary. Under the self-settled trusts, the beneficiary may continue to receive health care coverage through Medicaid but the funds remaining in the trust at the beneficiary's death must be paid to the State up to the amount paid on behalf of the beneficiary during lifetime.

3. With a third party special needs trust, the funds remaining in the trust at the death of the beneficiary, may be distributed to whomever the third party desires to receive them.

4. The nonprofit trustee of a pooled trust may retain all of the funds remaining in a beneficiary's sub-account at the beneficiary's death.

D. Statutory Requirements of 42 USC §1396p(d)(4)(A).

A Trust containing the assets of an individual under age 65 who is disabled (as defined in section 1614(a)(3)) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this title.

1. Assets of an individual. The assets allowed to be transferred to a SNT may be from an inheritance or gift, personal injury settlement or structured settlement, lottery winnings or even unclaimed funds found.

2. Under age 65. Only the self-settled SNT requires the beneficiary to be under age 65. If the Trust is established prior to the time the beneficiary has his/her 65th birthday, the trust exception continues to apply even after the beneficiary turns 65. However, no outside additions can be made after the 65th birthday.

3. Disabled. The Program Operations Manual System (POMS) at SI 01150.121 addresses the issue of whether a beneficiary of a SNT must be declared to be disabled by Social Security Administration or some other agency in order for the SNT to be valid. The answer is in the negative.

4. Established for the benefit of such individual. The controlling POMS at SI 01120.201.F.2 clearly states that a trust is considered to have met the "sole benefit requirement" if the trust benefits no one but the disabled individual during his or her life, but specifically allows for trustee compensation plus reasonable costs associated with investment,

legal and other services rendered on behalf of the individual.

5. Established by parent, grandparent, legal guardian or court. What if the disabled individual who owns the funds is physically but not mentally disabled? The statute tells us that s/he cannot establish the trust. The relevant POMS section, SI01120.203.B.1.e, says, “[t]he special-needs trust exception **does not apply** to a trust established by the individual himself/herself.” It goes on to say, “[t]he person establishing the trust must have legal authority to act with regard to the assets of the individual. An attempt to establish a trust by an individual without the legal right or authority to act with respect to the assets of the individual may result in an invalid trust.” So, if a parent or grandparent establishes the trust, there must be a written specific power of attorney by the competent disabled adult. Parents can act for minors without additional authority but guardians must obtain court authorization to establish the trust. It is the rare court who will establish the trust.

6. If the state will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid. There are some post death expenses which are allowed to be paid before the balance of the funds are sent to the State to reimburse it. In accordance with POMS SI 01120.203B.3, administrative expenses may be paid from the trust prior to reimbursement of medical assistance to the State but only if they are taxes due from the trust to the State or Federal government because of the death of the beneficiary or they are reasonable fees for administration of the trust estate such as an accounting of the trust to a court, completion and filing of documents, or other required actions associated with termination and wrapping up of the trust.

On the other hand, prohibited expenses are payment of debts owed to third parties, funeral expenses and payments to residual beneficiaries.

All self-settled trusts must reimburse all state Medicaid agencies. No third party trust has pay-back provisions.

II Background Information

A. Beneficiary's medical history. To properly prepare a Special Needs Trust, it is critical to obtain a complete copy of the Beneficiary's past medical reports relating to the disability of the Beneficiary. The reports might show that the Beneficiary is not disabled which immediately eliminates the Special Needs Trust as a vehicle to preserve public benefits.

B. Family financial, cultural, educational and social history. If the entire family is receiving public benefits, this information will allow the drafter to carefully and fully explain the "sole benefit" purpose of the trust. Likewise, it may show a history of poor financial management or financial savvy. The trust should be drafted with these considerations in mind.

C. Program utilization. The requirements of each public benefits program are unique. It is a critical part of the planning, implementation and administration of a special needs trust that the precise program utilized by the Beneficiary and the Beneficiary's family be determined. The only way to determine the program(s) is to secure a written document from Social Security or the Department of Children and Families. It is not unusual for a beneficiary to be enrolled in two or more programs.

D. Beneficiary's medical prognosis. With a medical prognosis, the trustee of a special needs trust will be equipped with the knowledge to develop an appropriate plan for use of the funds.

E. Beneficiary's abilities and capabilities. Generally, but not always, testing has occurred to determine the Beneficiary's abilities to perform certain tasks as well as the Beneficiary's capabilities to learn new tasks. These tests form the basis for an appropriate care plan. Testing should be done intermittently so plans can be adjusted as needed.

F. Beneficiary's needs. A detailed and precise report of the Beneficiary's unmet needs is a critical part of the trustee's plan. If a beneficiary has a basic need of shelter or to have a 24-hour care giver, the trustee must address this need in the plan and in the drafter of the trust must address it in the Trust.

III. Statutory Knowledge

A. POMS. According to the United States Supreme Court, "The Social Security Act is among the most intricate ever drafted by Congress. Its Byzantine construction...makes the act almost unintelligible to the uninitiated." *Schweiker v. Gray Panthers*, 453 US 34 (1981). The

Program Operations Manual System (POMS) at <http://policy.ssa.gov/poms>, is intended to spell out the rules for benefits and according to the opening paragraph on the Social Security website for POMS, it is the “...primary source of information used by Social Security employees to process claims for Social Security benefits. The public version of POMS is identical to the version used by Social Security employees except that it does not include internal data entry and sensitive content instructions.”

A. Resources. The rules regarding resources of an applicant are found at POMS SI 01110.000. Any asset not excluded by law, is counted toward an applicant’s limitation of having \$2,000 in countable resources. There are numerous excluded or exempt assets of an applicant such as:

1. Home, regardless of value.
2. Household goods and personal effects up to \$2,000.
3. One wedding ring and one engagement ring and durable medical equipment regardless of value.
4. An automobile of any value if it is necessary for employment or for medical treatment, modified for either the operation by or transportation of a person with disabilities.
5. Certain life insurance.
6. Certain burial spaces.
7. Burial funds up to \$1,500.
8. Property used in a trade or a business.

B. Income. The rules regarding income of an applicant are found at POMS SI 00800.000. Generally, income is counted on a monthly basis. The more income an individual has, the lower his/her benefit will be. An individual who has too much income in a particular month is not eligible for SSI in that month. But, not all income counts in determining eligibility and benefit amount. So long as an individual receives \$1.00 of SSI benefits in Florida, s/he will receive Medicaid benefits.

1. Definition of Income at POMS SI 00810.005 beginning 3/9/05:

“Income is any item an individual receives in cash or in-kind that can be used to meet his or her need for food or shelter. Income includes, for the purposes of title XVI, the receipt of any item

which can be applied, either directly or by sale or conversion, to meet basic needs of food or shelter.”

2. Definition of Income before 3/9/05:

“ Income is any item an individual receives in cash or in kind that can be used to meet his/her needs for food, **clothing**, or shelter. Income includes the receipt of any item which can be applied, either directly or by sale or conversion, to meet basic needs of food, **clothing**, or shelter.”

3. Examples of non-countable income are:

- a. Medical care and services.
- b. Social services.
- c. Receipts from sale, exchange or replacement of a resource.
- d. Income tax refunds.
- e. Payments by credit life or credit disability insurance.
- f. Proceeds of a loan.
- g. Bills paid for the individual by another (if paid for food or shelter, in-kind income rules apply).
- h. Replacement of income already received such as a lost paycheck.
- i. Weatherization assistance.
- j. Receipt of certain non-cash items (charitable gift of a van).

4. Deeming of income

- a. Parent to child—applies if child is under age 18, not married, not a head of household, lives at home and lives with parents who are not themselves SSI eligible.
- b. Spouse to spouse—only if the disabled spouse lives in the same household with the non-eligible spouse.

5. Changes to the Income and Resources Provisions for Supplemental Security Income (SSI) Based on Sections 430, 435, and 436 of the Social Security Protection Act (SSPA) of 2004

On August 9, 2006, the Social Security Administration (SSA) issued its final rule in the above-referenced matter. This rule revises the SSA’s

regulation for how to determine an individual's income and resources under the Supplemental Security Income (SSI) program, which provides payments to people who have income and resources below a specified amount. The rule becomes effective September 8, 2006.

This rule makes several changes that impact the determination of an individual's income and resources:

- ✓ Change the calculation of infrequent and irregular income from a monthly to a quarterly basis, and revise the definition of infrequent income
- ✓ The SSA will exclude the first \$30 per calendar quarter of earned income and the first \$60 per calendar quarter of unearned income if it is received infrequently or irregularly.
- ✓ Income will be considered "infrequent" if it is received only once during a calendar quarter from a single source and it was not received in the month immediately before or after that month.
- ✓ Exclude from income all interest and dividend income earned on countable resources under Section 1613(a) of the Social Security Protection Act.
- ✓ Exclude from income gifts used to pay tuition, fees, or other necessary educational expenses at any educational institution, including vocational and technical institutions.
- ✓ Exclude from resources grants, scholarships, fellowships, or gifts used to pay tuition, fees, or other necessary vocational expenses at an educational institution for nine months.
- ✓ Consider wages and unearned income from a uniformed service to be received in the month in which such compensation is earned (according to Leave and Earnings Statement)

In addition, under the revised rule, the above-referenced changes would apply to the determination of countable income and resources of an

ineligible spouse (living in the same household as an eligible individual)
or ineligible parent (of an eligible individual under the age of 18).

IV. TRUST PROTECTOR

A. Definition. A Trust Protector is an appointed position within a trust, to which is delegated certain authorities and responsibilities of trust oversight. While the trustee retains all day-to-day management decisions and fiduciary obligations, the Trust Protector usually has a very defined role.¹ The Uniform Trust Code² and some states³ have codified the role but Florida has not yet done so. Those states which do codify the Trust Protector role do not define the position as much as describe its possibilities. Florida will likely include some provision on “Trust Protectors” within the next few years but the statute will likely define the role not in terms of what a Trust Protector can or cannot do, but whether and to what extent a Trust Protector is deemed a “fiduciary” under Florida law.

B. Duties and Responsibilities.

1. **Mediate Disputes.** Beneficiaries of special needs trusts often request distributions that are denied by the trustee. The distributions might be properly denied; for example, to save the beneficiary from losing his or her Medicaid benefits, but the beneficiary is still upset and there can be repercussions to this disappointment. With a Trust Protector authorized to mediate disputes, the beneficiary or another interested party may request that the Trust Protector intervene through mediation.

2. **Distribution Management.** Few individual or corporate trustees sufficiently understand or want to understand special needs trust distribution issues. Even the most experienced and larger institutional trustees do not have the in-house talent of a specialist in public benefits. (And even if they did, this would only create liability, not minimize it.) Trustees understand that if a mistake is made, the beneficiary could lose his or her health insurance, a mistake that is costly.

¹ Restatement Third, Trusts §64, Comments b through d

² §808, Uniform Trust Code, National Conference of Commissioners on Uniform State Laws (2001).

³ See *e.g.*, § 15-7-501, Idaho Stat. (2004); § 55-1B, S.D. Probate Code (2004); 7 Wy. Stat. § 4-10-710 (2004).

3. **Trustee Removal and Replacement.** Trusts benefit from oversight.

Articles and experience have clearly shown that the right trustee selected on trust creation is not necessarily the right trustee some time later. There are as many reasons for wanting to remove a trustee as there are trustees who refuse to step down or trustees who want to step down. A Trust Protector may be granted the authority to remove the trustee and to appoint a more appropriate successor. With this authority in the right hands, the beneficiaries and the court benefit from a Trust Protector who might be authorized to “ride herd” over the Trustee, better ensuring the proper administration of the trust. If a Trustee wishes to step down or if an interested party seeks discharge, the court process can be expensive and time consuming.⁴ A Trust Protector granted authority to remove and replace the trustee is sometimes used as a safeguard for the court and the beneficiary. Some trusts authorize the Trust Protector to remove and replace trustees in the Trust Protector’s experience and sole discretion; others require the Trust Protector to bring matters to the attention of the court prior to removing the trustee.

4. **Approve Technical Amendments to Trust.** Trust amendments may be

necessary or advisable. The irrevocable special needs trust with proper provisions may be amended to comply with the law and rules as they change. With a Trust Protector in place, the court may be assured that appropriate changes will be made even if those changes are not in the best interest of the Trustee, though in the best interest of the trust and the disabled beneficiary.

C. Experience. The Trust Protector should have a skill set commensurate with the type and purpose of the trust. For example, with special needs trusts, the Trust Protector should, at a minimum, have demonstrable skills in public benefits issues and trustee oversight.

D. Insurance. Where a Trust Protector’s actions can cause the trust harm, there should be sufficient insurance to cover the risk. The Trust Protector should be a “recoverable” entity or person. General liability policies and attorney malpractice policies are insufficient because they do not cover the high-risk functions a Trust Protector must exercise.

While insurance is very important, bonding is less helpful because the Trust Protector does not ordinarily have direct access to the funds. What must be covered is the risk of negligent actions (or inactions) by the Trust Protector; a good liability insurance policy can cover

⁴Edwin P. Morrow, III, *Trust Protectors: The Good, The Bad and The Ugly*, Capital Trust (CTC Delaware 2002).

that risk. It is appropriate to request a copy of the declaration page of the insurance policy evidencing at least \$500,000 in coverage, per incident, for Trust Protector services.