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**SPECIAL NEEDS TRUSTS: PITFALLS TO AVOID**

Patricia A. Nelson-Reade

Special needs trusts are a very useful tool for family members and loved ones to preserve funds for the benefit of an elderly or disabled individual. Assets can be placed in such trusts for the benefit of the elderly or disabled person so that government benefits are maintained, and the trust funds are available, at the discretion of the trustee, to enhance the individual's life beyond what the government benefit programs provide. Because the trust owns the assets, a trust that is properly written and funded will not affect the individual's public benefits. The result is that the overall funds available to assist the elderly or disabled individual may be greatly increased – a situation which can make a significant difference in the individual's quality of life. The funds in the trust “supplement” what funds are available to an individual from other sources, including government benefit programs, and that is why these trusts are known as supplemental or special needs trusts.

**OVERVIEW OF SPECIAL NEEDS TRUSTS**

**I. First Party and Third Party Special Needs Trusts**

The requirements governing special needs trusts vary depending upon which public benefit program the special needs trust is seeking to preserve, and depending upon whether one is creating a self-settled trust – that is, a trust created with funds of the beneficiary – or a third party trust created with funds of another individual.

**A. First Party or Self-Settled Special Needs Trusts**

Two of the most common means-tested public benefit programs are Supplemental Security Income (SSI), which provides a monthly income benefit for disabled and elderly persons, and Medicaid, which is a medical insurance program for disabled or elderly persons.

The laws and rules for MaineCare, Maine's Medicaid program, and SSI provide only two types of supplemental needs trusts that can be used when assets of an individual – for example, a lawsuit settlement or an inheritance – are used to fund the trust. In these situations only, MaineCare and SSI will not consider the assets to have been transferred to the trust so as to create transfer penalties, and the assets in the trust will not be considered fully available, and therefore the individual may be eligible for MaineCare and SSI benefits even if there are substantial assets in the trust.

The first type of trust – and by far the most common – can be used only when an individual is under 65 years of age and disabled under the Social Security Standards at the time the trust is established and funded. The key requirements for this type of trust are as follows:

- a. the trust must be irrevocable;
- b. the trust must be created and funded when the beneficiary is under age 65; any assets added to the trust after the individual turns 65 will not be considered exempt;
- c. the trust is established by a parent, grandparent, legal guardian, or a court;
- d. the trust must be for the sole benefit of a person who meets the SSI criteria for disability; and
- e. the trust must provide that, on the death of the beneficiary and after legal obligations of the trust (e.g., taxes, trustee fees) have been paid, the State will be repaid for any benefits provided to the individual under the MaineCare program (and any other state Medicaid program that pays for expenses) before any remaining trust assets are distributed to remainder beneficiaries.

## **B. Pooled Trust for self-settled assets**

If an individual is 65 or older, the only available trust option is a non-profit disability trust. Under the rules, the requirements for this type of trust are:

- a. the trust must be established by a non-profit association;
- b. the beneficiary who provides the assets must be disabled under the SSI criteria;
- c. the association must maintain a separate account for each trust beneficiary, although it may pool trust assets for purposes of investment and management;
- d. the trust account must be established solely for the benefit of the disabled individual, and must be established by the individual, the individual's parent, grandparent, legal guardian, or a court;
- e. although the rule actually states that the State must be repaid to the extent that assets remain in the beneficiary's account at his or her death, the Maine Pooled Disability Trust, which is currently the only non-profit trust in Maine approved by the Department of Health and Human Services as meeting the rule requirements, requires that one-half of any proceeds remaining in the trust must be retained by the trust to assist with the trust's purposes, while the remaining funds must first be

used to reimburse MaineCare before any remaining funds go to beneficiaries named by the disabled individual at the time of the establishment of the trust fund account.

The Maine Pooled Disability Trust is the only self-settled pooled supplemental needs trust established in Maine. The purpose of this pooled trust is to provide disabled individuals with an option for transferring their own assets into a trust that allows them to become eligible for MaineCare and/or SSI benefits and still have the transferred assets available to enhance the quality of their lives. The trust is an available option for people who have a minimum of \$5,000 (reduced from \$10,000 to \$5,000 in April, 2011) to place in the trust. For those under 65 who meet the other criteria discussed above, the pooled trust may be particularly appropriate for modest amounts that do not justify the administrative expenses of an individual trust and/or for individuals who do not have appropriate family members or professionals to serve as trustee. Currently Maine imposes a penalty for transfers to the pooled trust for disabled persons 65 years or older if nursing home becomes an issue within 5 years of the transfer. The imposition of a penalty period is being challenged in court at this time by the Maine Pooled Disability Trust.

The assets transferred to the Maine Pooled Disability Trust are pooled with those of other individuals participating in the trust and are managed by the trustee, with an individual sub-account that tracks the assets for each participating beneficiary. Subject to the discretion of the trustee, the assets are available to enhance the individual's life by paying for uncovered medical or other costs, "extras" such as vacations or other entertainment, and other items. Because the trust is a pooled trust, start up and administrative costs and fees are generally less than what it would cost for an individual to set up an individual trust that complies with the SSI and MaineCare rules. Also, there is a professional managing the assets and the distribution decisions rather than a lay person.

After the disabled individual dies, the Maine Pooled Disability Trust retains one-half of the deceased individual's subaccount (to assist other disabled individuals) and then reimburses the State of Maine for MaineCare benefits paid on behalf of the beneficiary. Any amounts remaining are distributed to remainder beneficiaries named by the disabled individual at the time the trust account was established. The Maine Pooled Disability Trust website is: <http://mainepooleddisabilitytrust.org>.

### **C. Third Party Special Needs Trusts**

Not surprisingly, the rules for third party trusts – that is, trusts established with funds of another individual other than the beneficiary – are more generous than those for self-settled trusts. Using this type of trust allows an elderly or disabled person to inherit

or receive assets of another, either during life or at death, without jeopardizing their public benefits.

The SSI and MaineCare rules governing third party trusts are relatively straight forward. The trust assets are not considered available to the beneficiary if the beneficiary, any responsible relative residing in the home and any member of the assistance unit cannot revoke the trust or change the beneficiary. Because any funds made available to the beneficiary are considered available to him/her, it is advisable that the trust leave the amount and frequency of any distributions of income or principal to the discretion of the trustee so that only “countable” distributions from the trust will count as an asset or as income to the beneficiary.

For both third party and first party special needs trusts, under SSI rules, trust distributions for food or shelter are similar to cash distributions and may in part reduce the SSI benefit in the month received by either dollar for dollar or up to one-third of SSI Federal Benefit Rate (1/3 of \$674 for 2011) for in-kind maintenance and support. In contrast, under MaineCare rules, as long as the distributions for food or shelter (or anything else) are paid directly to the vendor, there is no impact on MaineCare benefits. Such distributions would be considered income if they were made to the MaineCare recipient, but are not counted as income if they were made to others on behalf of the MaineCare recipient.

#### **D. Third Party Pooled Trust**

The Maine Trust for People with Disabilities (MTPD) is the only third party pooled trust established in Maine available for individuals who reside in Maine and who suffer from a developmental disability. Unlike the Maine Pooled Disability Trust, an account with MTPD can only be established with funds that are not from the disabled individual; the funds must come from someone else, usually a family member or friend. Rather than being a pooled first party trust, it is instead a pooled third party trust. The MTPD has been approved by the Maine Department of Health and Human Services (DHHS) and by the Social Security Administration as meeting their criteria for a third party special needs trust, and therefore those disabled and elderly persons with accounts in the trust are still eligible for SSI and MaineCare.

The MTPD offers similar advantages in terms of pooling of assets, and sharing of trust management fees among multiple account holders as discussed above for the Maine Pooled Disability Trust. The minimum fee to establish an MTPD account is \$25,000. These funds can be contributed during the donor’s life or at death through a will or beneficiary designation. If funded during the donor’s life, the funding must occur within 5 years of the establishment of the account. If funded at death, the funding must occur within a reasonable time from the death of the donor.

Because the MTPD is a third party trust funded with assets of others there is *no* requirement that any remaining trust assets be used to reimburse MaineCare after the beneficiary's death. When the trust account is established, the party establishing the account determines who will get any remaining funds when the beneficiary dies, and that person can be another family member or individual, a charity, or even the MTPD. The MTPD website is: <http://www.themainetrust.com>.

## **PITFALLS TO AVOID**

Drafting the special needs trust to meet the goals of a client and the criteria for public benefits planning is very important to meeting the primary goal to enhance the beneficiary's life without unnecessarily impacting public benefits. Administration of the trust is just as important to meeting this primary goal.

Trustees have a number of duties, including the duties to administer the trust consistent with its terms and purposes; to inform and report to the qualified beneficiaries; to invest the assets prudently; to prepare tax returns and related documents; and to terminate the trust in accordance with the trust's terms. Special needs trusts create special issues related to trust administration. I have identified the most common issues that I see in trust administration of special needs trusts:

1. Identify the type of trust. First Party Trust or Third Party Trust?  
Who contributed funds to establish trust?  
State has different interests – eligibility for both and creditor for First Party  
DHHS and SSA approval of self-settled trusts
2. Confirm beneficiary's public benefits and optional public benefits  
SSDI and SSI  
Medicare/MaineCare  
QMB – Qualified Medicare Beneficiary  
Section 8 housing – irregular distributions that cannot be counted  
Food Assistance Program  
Fuel Assistance  
Real Estate Tax Refund
3. Dance between the public benefits to make the most of them  
Necessary or public benefit optional benefit?  
Timing of distributions
4. Sole Benefit Issue of Self-Settled Special Needs Trust  
Documentation of decisions

Ask for permission or justify decision

5. Trustee's relationship to public benefits  
Who makes reports to public agencies?  
Beneficiary, guardian/conservator, power of attorney, trustee???  
When to report to public agencies – countable distribution and upon request
6. Prudent investment and tax planning  
Self settled special needs trust = grantor trust  
Third party trusts and accumulated income
7. Termination of Trust  
First Party Trust - Reviewing claim from Estate Recovery – FAPE expenses, QMB expenses, expenses before date of trust
8. Balance between really making a difference and being eaten alive  
Care manager; family member  
Systemize distributions via plan