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ESTATE PLANNING STRATEGIES FOR DISABLED BENEFICIARIES USING SPECIAL NEEDS TRUSTS AND ABLE ACCOUNTS

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A PRIMER

I. Introduction

Leaving an inheritance to benefit persons with disabilities, whether minors or adults, has been a difficult challenge for parents and other benefactors for several decades. When parents or grandparents have created standard support trusts for the purpose of providing financial assistance to disabled individuals, oftentimes the creation of a support trust will interfere with public benefits[1], such as Medicaid and/or SSI (Supplemental Security Income), which would otherwise be available to the disabled beneficiary. For higher net worth parents, such concerns may be irrelevant. However, due to the massive cost (typically), of providing housing, supportive living arrangements, health aides or other caregivers, transportation, medical care, prescriptions, and other assistance, significant sums of money will be required, resulting in a trust of, sometimes, seven figures in size if the beneficiary lives to a typical life expectancy. Although certainly some families are able to provide such benefits and are not concerned in the least about integrating trust provisions with public benefits; most families, including the majority of middle-class Americans, find it difficult to accumulate sufficient assets with which to leave a trust or inheritance of sufficient size to provide the ongoing lifetime care for their disabled loved one. Even if it is assumed that the disabled beneficiary will reside with other family members,

[1] See benefits chart attached as "Appendix A."

such plans sometimes may work for a period of time, but eventually the needs and care of the disabled person may be so overwhelming or even destructive to the life of a care-giving sibling that the family may find it necessary to locate other housing and living arrangements for the disabled person. Accordingly, individuals may seek other alternatives to the standard, traditional support trust in order to assist and enhance the quality of life of their disabled family member.

II. Writing the "Wrong" Prescription—The "Standard" Support Trust

If a parent or other benefactor creates a standard "support" trust for the benefit of a disabled person, often the Trustee merely determines the needs of the disabled person and makes distribution from the trust, either pursuant to compulsory provisions or, if discretion is permitted, in accordance with the Trustee's discretion after determining the beneficiary's on-going needs. If the trust <u>required compulsory distribution</u> of income and/or principal on a periodic basis, then distributions from the trust will most likely be considered as part of the income or assets of the beneficiary <u>when received</u>, which may well affect the right to public benefits when the beneficiary's financial status is reviewed by the State. Thus, the mere existence of the trust will trigger suspicion on the part of the State resulting in a request to review the trust document and an inquiry as to the nature of any distributions made by the Trustee [*see Trust Company of Oklahoma vs. State, ex rel. Department of Human Services*, 1991 OK 133, 825 P.2d 1295 (1991)]. *See also McAlary v. State ex rel. Oklahoma Dept. of Human Services*, 2010 OK CIV APP 39, 233 P.3d 399, discussing the analysis required to determine if a trust is a countable resource. The State will typically view distributions as income to the beneficiary depending upon what the distributions were for. Food, shelter related expenses, or distributions of cash and other trust assets <u>may be</u> deemed "resources" available to him/her and it may result in a cessation of future benefits otherwise payable by the State especially if the beneficiary has the right to request or compel distributions. *See Trust Co. of Oklahoma v. State ex rel. Dept. of Human Services*, 1995 OK 12, 890 P.2d 1342, ¶0. If the individual were living in a group home or other facility paid for substantially through Medicaid, the beneficiary may suddenly find himself or herself without support by the State and, thus, thereafter thrown upon the trust for full support until the trust is consumed (assuming the trustee was willing and authorized to make such distributions). This most likely would defeat the grantor's or testator's intentions, since most grantors or testators would not intend to supplant public benefits with the trust they created.

Prior to the passage of the Omnibus Budget Reconciliation Act ("OBRA") by Congress in August of 1993, a "third party" trust created by another person (*e.g.*, parent or grandparent, etc.) for the benefit of a disabled person was required to be a special needs trust by its terms in order to avoid the trust assets being deemed available for support of the beneficiary. After the passage of OBRA, third party trusts created thereafter will not be treated as automatically available as a resource to the disabled person. However, the Trustee should still avoid making disqualifying distributions such as cash or cash equivalents such as a debit card or distributions that are for food or shelter related expenses. In addition, compulsory distribution provisions, even post-OBRA, could be fatal to the continued receipt by the beneficiary of certain public benefits, such as Medicaid and SSI. Compulsory distributions especially at age milestones should be avoided.

III. The Not-So-Great Alternatives

- **Disinheritance.** Due to the inability of many families to create full support trusts of sufficient size to pay for the massive costs for care, medical services, food, clothing, shelter, etc., of a disabled child, some have selected the very emotionally painful option of disinheritance. This approach has been the common choice in past years for many families of modest means (and even some families with substantial wealth). Disinheritance will indeed preserve any public benefits to which the beneficiary might otherwise be entitled, since the parent or other benefactor has declined to leave any specific assets or income to the disabled person. Although this approach is workable, it is our firm's experience that most families find this option incredibly distasteful and emotionally traumatic, almost feeling that they have abandoned their disabled child, a child in which there is often a tremendous emotional investment, notwithstanding the financial drain and emotional and marital strain often suffered by families with disabled children. In spite of the emotional trauma, however, some parents still opt for this "solution."

- **<u>Leave Property/Money to Other Heirs</u>.** Another option sometimes desired by clients, is leaving an inheritance to another child or other family members with the "understanding" that the recipient will use the funds or assets in some form or manner to benefit the disabled person without disqualifying that person from receiving public benefits. Sometimes the benefactors of the gift anticipate that the person receiving the property in this more or less "secret" trust arrangement, will actually provide personal, in-their-home care for the disabled person. Sometimes the recipient may promise or assure the parent that, indeed, that will be the case (*i.e.,* provide care). However, sometimes no matter how well intentioned the recipient of the property may be, the actual provision of the ongoing care may be untenable. This is a more or less "secret" arrangement, with no written document creating an enforceable trust. There are, of course, tremendous risks with this approach, since the recipient of the assets will most likely be considered the legal owner thereof, and could expend the funds, or they could be exposed to creditors, or risk of loss in a divorce proceeding, or other hazards. Furthermore, it may be difficult for the disabled "beneficiary" or his/her legal representative to legally enforce the informal "trust" arrangement against the recipient of the assets. Thus, the client cannot be assured that leaving the additional property to another family member <u>will</u> result in actual use of the bequest for the benefit of the disabled child.

IV. <u>Supplemental or Special Needs Trusts—What Are They and When Should They Be Used?</u>

The term "Supplemental Needs Trust" ("SNT") is sometimes interchangeably used with the term "Special Needs Trust." Although these terms historically had different meanings, they are often used to refer to trusts designed to benefit a disabled person who is receiving some type of public benefit. A "third party **<u>supplemental needs trust</u>**" is typically created by a parent, grandparent, or other person <u>using their own assets</u> to benefit a disabled child or other disabled beneficiary without interfering with public benefits otherwise being received by that disabled person. These often include language instructing the trustee not to disrupt available public benefits, unless doing so is in the beneficiary's best interest.

A **"**first party **special needs trust"** is a creature of statute, although the term is not actually used in the statute. The statutory special needs trust, along with other trust types, was created as a part of OBRA by Congress to assist persons entitled to disability benefits who otherwise would be disqualified by an inheritance, a personal injury award, or receipt of assets from other sources. These are funded with the beneficiary's own assets and so are overlooked in determining or maintaining eligibility for public benefits, so long as they also contain required language for distribution of funds at the beneficiary's death.

- **Why Should a Supplemental Needs Trust Be Considered?**

Under current law, a person receiving certain types of public benefits, such as Supplemental Security Income (SSI), "Waivered Services" (typically, Medicaid payments from the State due to a disabling condition of a child or adult), or other forms of public benefits, requires that the recipient have very limited income and assets in order to receive or maintain qualification for public benefits. Both SSI and Medicaid programs are basically "poverty programs" and qualifying for such benefits requires the recipient to be more or less financially impoverished. Thus, if a disabled individual were to inherit property outright, or were to be the beneficiary of a full nondiscretionary support trust which required by its terms distribution of income and/or principal on a periodic basis, such status as beneficiary of such support trust or as direct beneficiary of an inheritance or other property (including, for example, by means of a gift such as via the Uniform Transfer to Minors Act or similar statutory authority), will normally disqualify the disabled individual from receiving or continuing to receive public benefits. It is not uncommon that grandparents unwittingly leave an inheritance to a disabled grandchild (sometimes unknown to the parent of the disabled grandchild) which (depending on the size of the gift), will, upon receipt by the grandchild, immediately disqualify that grandchild from being eligible for public benefits. Thus, adequate knowledge and understanding of public benefits law is essential for estate planners to be able to counsel clients who may be disabled or where there are members of the client's family for whom the client wishes to provide some lifetime gifts or post-death benefits through their testamentary documents.

The States have wrestled with the issue of the legitimacy of parents or other family members creating so-called "supplemental needs trusts" while attempting to preserve public benefits for the disabled beneficiary. Without some detailed understanding of this area of law, the otherwise competent estate planner may unwittingly create a hazardous condition for the disabled person, resulting in the trust, inheritance, or other gift disqualifying that person from receiving public benefits on which they rely. This could result in the inheritance or trust assets being prematurely consumed before the disabled individual can reapply for public benefits. However, as discussed hereafter, there are ways to preserve public benefits even if an inheritance has already been received by a disabled beneficiary by using statutory "pay back" trusts.

V. Supplemental Needs Trust—Is It the "Right" Prescription?

Many families with disabled children who wish to feel that they are dealing responsibly with their special needs child or grandchild, will often desire to create a normal or standard support trust for that person. However, due to the tremendous cost associated with providing support for a disabled child which, of course, depends on the degree of disability, many ordinary families simply cannot accumulate sufficient assets in their lifetime or purchase sufficient insurance (of a whole-life nature), to adequately fund a trust for a disabled child needing full support. Sometimes a parent or parents of a disabled child, arrive at an age where they are simply no longer able to provide in-home care for their disabled loved one. In such a case, residential placement is often desired or necessary to provide ongoing care for the disabled child. In doing so, the parent will find that it is essential that the child have minimal assets in order to qualify for state supported benefits in a group home or other living facility. It then begins to dawn on the parents that leaving the disabled child an inheritance will disqualify the arrangement that has been created for the child's current and long-term care needs. Once the parents discover the massive costs to provide that ongoing support, they are faced with the dilemma of creating a full-support trust for the child, or facing one of the other options, such as disinheritance or leaving money to other heirs in a "secret" trust, as mentioned above. If the parent has accumulated sufficient assets, or sufficient assets will arise as a result of the parent's death (*i.e.,* via life insurance), then a standard support trust may be the preferential choice of the client, who has basically abandoned the pursuit of public benefits for the child or other family member, or who wishes to discontinue such benefits upon the death of the parent as a result of the full-support trust coming into place. This is more or less a "Y" in the road analysis, conducted as part of the client interview process in order for the client to understand the extent of assets required to fully support a disabled child.

- **Benefits of the Supplemental Needs Trust.** Mentioned previously, the SNT is designed to provide certain benefits to a disabled person without disqualifying that person from receiving public benefits. The SNT comes along side, so to speak, the public benefits and disburses funds in a way that will not trigger disqualification by the State. Such things as more sophisticated medical care, special equipment, sporting equipment or activities, entertainment items, (e.g. Disney World) travel and recreational experiences, hiring of assistant or additional therapists, caregivers, companions, and other types of arrangements, can provide a remarkable blessing to the disabled person. Thus, the SNT can enhance the quality and enjoyment of life for the disabled person without interfering with the public benefits provided by the State.

  Another use of the SNT is to engage advocates, legal or otherwise, to investigate the care of the disabled beneficiary and insure that adequate health care, social activities, financial watch care, and other arrangements are being satisfactorily provided to the beneficiary. Some individuals who are disabled do not require a guardian of their finances (since they actually have or possess very little), and others, for whatever reason, have no guardian of their person even though one would be beneficial. In such cases, the trustee can perhaps engage a third party (*i.e.,* care manager) to provide that source of oversight to ensure that the beneficiary is receiving maximum services from the state, and those services that are provided through agencies or other caregivers are done so in a satisfactory manner. Advocacy is an extremely important need of disabled persons, particularly those who are not able to advocate for themselves effectively. Thus, the SNT would be a very useful source of funding for special advocates of one form or another to ensure that all available benefits from the state are being received and the quality of them are at an acceptable level.

Notwithstanding the tremendous potential benefit to disabled persons of an SNT, its use and assistance to the disabled beneficiary is often limited by the quality of the services of the Trustee. Due to the fact that many disabled persons are not able to adequately advocate for themselves, demand upon the Trustee for disbursement, or oversight of the needs of the disabled person is often lacking, thus, <u>the trust could simply vegetate in an investment mode without serious inquiry by the Trustee</u> as to the needs of the beneficiary. Sometimes it is important for the benefactor and creator of the trust to notify another family member or other interested person as to the existence of the trust so that a third party (perhaps a guardian, if one exists, or "Trust Advisor," "Trust Protector," or "care manager") can be sure and oversee the Trustee to insist that the Trustee becomes involved in some form or manner in the beneficiary's life to insure the actual use of the trust for the disabled person's benefit, so that it doesn't become simply an investment for the benefit of the trustee, or remainder persons. The issue, therefore, of the selection of a Trustee for the SNT is very critical, and the individual or corporate Trustee assuming that role must be prepared to undertake the sometimes heavy responsibility associated with it.

VI. Options for Utilization of an SNT

A SNT is a type of trust that can be added to a Will as a recipient of a certain portion of the estate; or it can be placed inside a Revocable Living Trust, or it can be an independent, "stand-alone" trust, whether revocable or irrevocable, or part of a life insurance trust, etc. Each of these approaches has certain pros and cons.

- **SNT Placed in a Will.** The simplest implementation of a SNT is simply to "drop" Supplemental Needs Trust provisions into a Last Will. The SNT is designed to receive either a specific dollar amount from the estate or perhaps a percentage of the residue as determined by the testator. The probate estate will be eventually closed, but the trust will thereafter continue, typically for the lifetime of the disabled person, and terminate upon the death of the beneficiary. Thereafter, provisions would typically be made for alternate distributions to other family members then living, or a combination of family members and/or charities, etc. The disadvantage of the SNT in a Will is that it is available for public viewing, as a matter of public record in the probate case and, therefore, available to the State at any time along with exposure of the client's other relevant Will provisions, which some clients prefer to keep confidential.

- **<u>Supplemental Needs Trust Inside a Revocable Living Trust</u>.** Since revocable living trusts or grantor trusts have become wide-spread in their use, many clients who wish to create a Supplemental Needs Trust will simply want to add it to their revocable trust in a manner similar to that of it being placed in a Last Will. This is a relatively common approach and provides the "privacy" typically desired by clients of revocable trusts, although the State, if it learns of the existence of the trust, will normally require a full copy of the trust be provided to it. Accordingly, clients may opt for the third choice noted below, since they may not wish to expose their entire revocable trust contents to the State.
- **<u>Independent "Stand-Alone" Supplemental Needs Trust</u>.** In recent years, due to the desire for financial privacy by clients, and the desire to create a trust capable of receiving gifts from other individuals, some attorneys recommend using a stand-alone Supplemental Needs Trust, either revocable or irrevocable. Typically, the trust will be a form of grantor trust funded with perhaps a nominal sum and retaining the power by the grantor to revoke or amend it at any time. The trust can be the recipient of assets from other sources, such as grandparents, thus, relieving the grandparents from having to create a Supplemental Needs Trust in their own documents. Gifts could be made to the SNT during the lifetime of the donor or upon his/her death. Depending upon the size of the gift from a grandparent, gift tax issues may arise, if the gifts are *inter vivos* gifts. If examination of the document was required by the State, they would be reviewing only the stand-alone trust and not the rest of the client's estate planning documentation.

VII. Funding the Supplemental Needs Trust.

- **Size of Trust Needed.** Since Supplemental Needs Trusts are not providing primary support for a disabled individual (because government benefits are doing so), the amount of disbursement and, therefore, size of the trust is not as large as might be envisioned for a full support trust. Such trust, if managed by an individual trustee, may be well less than $100,000.00, since the earnings alone may be sufficient to supplement the beneficiary's public benefits. If more recreational activities or other services are desired by the creator of the trust, then of course there is no limit to the actual size the trust could be. However, most families do not wish to create a larger trust than is actually necessary to benefit the disabled child unless that child is their only child. There would be nothing wrong with consuming the trust and, if one was able to artfully calculate the life expectancy of the beneficiary then, ideally, upon the death of the beneficiary, the trust would have been fully consumed. As a practical matter, such calculations are unrealistic since some disabled individuals may live close to a full or normal life expectancy, and others may suffer an untimely death unanticipated by all involved in the planning process.
    - As an additional practical matter, if a corporate trustee is preferred then the annual administration fees must be considered. Will a corporate trustee require a certain trust corpus before they'll accept the role as trustee? A survey of local trustee fee schedules reveals no minimum size requirement; but there are annual fees calculated as a percentage of the trust assets ranging from .65% to 1.5% with annual minimums from $4,000 to $7,000 (paid monthly) to serve as trustee of a special needs trust. When compared to a

standard trust's typical fee schedule, usually calculated as a percentage of trust assets annually (starting at .65%) if a corporate trustee is desired, the trust needs to be of a certain size to tolerate the fee schedule plus other administration costs (i.e. tax return preparation, accounting services and the like). The client's ability, or lack thereof, to provide a Supplemental Needs Trust of at least $250,000.00 to $450,000.00 may determine whether or not a corporate trustee can be selected. This raises the whole issue of the safety of selecting natural persons as trustees versus corporate trustees, and the accompanying risk of embezzlement, foolish investments, etc. Greater protection for the beneficiary, often desired by the parents, may encourage the creation of a trust of adequate size to attract the interest of a corporate trustee. There are some non-profit charitable organizations that will serve as trustees of much smaller trusts, however, and using one may be a viable option for the client. Younger parents often have been unsuccessful in accumulating sufficient assets with which to fund the SNT and often rely upon life insurance to provide the cash (upon the death of a parent) to fund the SNT, either in their Will or in a revocable trust. However, the life insurance policy will only be of use if it is maintained throughout the lifetime of the insured parent and it remains in force at death. This may mean the client is required to purchase whole life insurance of some form, and have sufficient income/assets with which to maintain the premiums.

The SNT can be funded from the <u>general assets of the estate</u> or the living trust, as a percentage of the residuary. Again, this requires that the client (parents, etc.) will have accumulated sufficient assets with which to fund the SNT, and will not have consumed those assets for long-term care expenses caring for themselves. <u>One of the greatest threats to adequately funding the Supplemental Needs Trust is the consumption of the estate of the parents/benefactors prior to their deaths, thus leaving no significant assets with which to fund the Supplemental Needs Trust.</u>

- **<u>Coordination of Supplemental Needs Trust with Charitable Remainder Trust</u>.** Use of a charitable remainder trust can meet several estate planning objectives: charitable giving, tax avoidance, and leaving a legacy for a disabled beneficiary. A charitable remainder unitrust (CRUT) or charitable remainder annuity trust (CRAT) could make payments of its unitrust income or annuity income to a Supplemental Needs Trust for the benefit of a disabled individual. CRATs pay out a fixed percentage of the trust's initial value each year until the trust terminates (at the death of the Grantor). After the initial contribution, no additional contributions are allowed but the Grantor may choose to take income distributions during his/her lifetime or can designate a non-spouse beneficiary (i.e. disabled child) to receive annuity distributions annually. Annuity distributions are taxable each year to the noncharitable beneficiary and reported on a K-1 from the trust to the extent of income earned by the trust. In contrast, a CRUT pays a fixed percentage of the trust's asset value (unitrust amount) recalculated and redetermined each year. Grantors of CRUTs may make additional contributions after the initial contribution and can make distributions to the Grantor or to a named beneficiary. Thus, this arrangement will allow the creator of the trust to have certain income tax benefits or estate tax benefits and still provide benefits for a special needs child. At the Grantor's death the trust would pass to a charity or charities selected by the parents/benefactors.

- **<u>Pourover From a Revocable Trust or Other Sources</u>.** As stated previously, a stand-alone Special Needs Trust could receive assets from other sources, such as life insurance, an IRA or other qualified plan, another benefactor such as a grandparent or other sibling, or, as a transfer from the grantor's other revocable trust or estate via a last will. Thus, the parent/benefactor could provide in their revocable trust that a portion of the remaining assets in the trust after grantor's and/or grantor's spouse's death pass to the stand-alone trust and be added to it to fund the SNT further. Sometimes, formulas can be included in the revocable trust of the parent, so that the stand-alone trust ends up with a sum not to exceed, or not-to-be-less-than, a predesignated amount determined by the parent, after the stand-alone trust has acquired assets from multiple sources.
  - Distributions from an IRA to an SNT are governed by the SECURE Act and were changed by SECURE 2.0. So trustees of SNTs receiving these should be aware of distribution rules for non-designated beneficiaries depending on when the IRA owner died (before or after the required beginning date will dictate 5 year or longer distribution period). The original SECURE Act allowed an SNT for the sole benefit of a person with a disability to stretch the IRA distributions over his or her lifetime. Section 337 of SECURE 2.0 expands this to allow an SNT with a remainder beneficiary that is a qualifying charity to be considered a see-through trust (and count as an Applicable Multibeneficiary Trust "AMBT") so that the beneficiary can take the IRA distributions over his or her

lifetime. This is only true for certain charities (not private foundations or donor advised funds). IRC §408(d)(8)(b)(i) lists qualifying charities. *Drafting note: The document can give the trustee ability to change charitable beneficiary but require that the charity qualify under that IRC section. Also, note: a charity administering a pooled trust does not count as a qualified charity according to the IRS. Best practice is for SNTs intended to receive retirement benefits to include a statement of Grantor's intent that the SNT qualifies as an AMBT.

- It is still true that under SECURE 2.0, if an IRA owner designates a disabled or chronically ill individual as the beneficiary, as opposed to an SNT, then s/he qualifies as an eligible designated beneficiary (EDB) and can stretch the distributions over his or her lifetime. *See* Section 326

VIII. Administering the Supplemental Needs Trust.

A trustee must take care to distribute funds for the benefit of the beneficiary in a way that maintains eligibility for whatever benefits the beneficiary is receiving (SSI, Medicaid). That means taking into account the income and resource caps, the latter being $2,000. When distributions can be made for the benefit of rather than directly to the beneficiary, that is generally preferred. Paying for goods and/or services for the beneficiary and not distributing cash should be the manner of distribution. For example: the trustee could purchase new technology devices (computer, iPad, gaming console) that enhance the qualify of life for the beneficiary. The trustee could also pay for car insurance, cable and internet service for the beneficiary issuing payment monthly directly to the provider. None of that counts as income to the beneficiary and provides significant benefit. The trustee must avoid making distributions that count as income, even if they're not directly to the beneficiary. These types of distributions include things that Medicaid or SSI are intended to cover: food, shelter and medical expenses. *See* Social Security Act §1612a, 20 CFR 416.1102, 1103. *See also* SI00835.400. These expenses should be paid from the beneficiary's SSI income leaving the "extras" to be paid for by the trust. If an SNT is used for food or shelter expense, such distributions count as income and result in a reduction of SSI benefits by up to one third. SI00835.400

- **<u>SNT from the Beneficiary's Perspective</u>.** The beneficiary who desires independence and autonomy may find the administration of the trust estate challenging. This beneficiary has a disability or diagnosis which when managed well allows her to pay monthly bills, shop, and seek to make her own decisions about what the trust should pay for. A good way to handle a highly independent beneficiary is to establish a monthly budget, work together to determine what expenses the government benefits will cover (food and shelter) and what expenses can be borne by the trust (cell phone, internet, cable, car insurance, medical or dental visits or prescriptions not covered by Medicaid). Extraordinary purchases can also be covered by the trust so long as the trustee is careful to consider whether they may be considered income and destroy eligibility for the government benefits. It sometimes surprises trustees to learn that property tax payments, home insurance and utility payments are considered income to a beneficiary if paid by distributions from a special needs trust. *See* POMS SI 00810.005. One-time payments can be an exception; but the analysis is critical.

IX. Self-Settled Special Needs Trust (or Medicaid “Pay-Back Trusts”)

Prior to 1993, whenever a person receiving public benefits based upon the person's disability (having also qualified due to limited income and/or assets), found themselves a recipient of an inheritance, a personal injury award, or recipient of a trust requiring compulsory distribution of income and/or principal, they would often find themselves shocked to experience the loss of public benefits until the inheritance or assets were consumed or the trust spent down adequately to requalify them for public benefits. However, in 1993, as part of the Omnibus Budget Reconciliation Act, Congress amended Title 42 of the United States Code (Social Security provisions), creating a more or less "safe harbor" for individuals finding themselves suddenly disqualified due to their "unfortunate" status as a beneficiary or the recipient of inherited property. In the OBRA provisions, Congress set forth certain types of special needs trusts which the disabled individual, or someone on behalf of and acting for the individual, could create, thus preserving public benefits which otherwise would be lost. This has become a remarkable tool to protect disabled clients who have found themselves the recipient of property from parents or other persons who are unaware of the relationship between inheritance and access to public benefits.

These trusts are sometimes called "disability trusts," or “Medicaid Pay-Back Trusts,” or “First-Party Special Needs Trusts” and are found in Section 42, United States Code, §1396(p)(d)(4)(A) and (C). For lack of a creative title, these types of “self-settled” or “first party” trusts are established using the beneficiary's own assets and are often called by the section of the statute under which they are described, *i.e.,* a "d(4)(A)" trust. In this circumstance, a trust is created by or on behalf of the individual and the language thereof is typically often associated with the language in a supplemental needs trust created by a parent using the parent’s resources.

However, the "fly in the ointment" is that upon the death of the disabled person, <u>the balance in the trust must be paid to the state or states that provided public benefits</u>, <u>up to the amount expended on behalf of the disabled person from the date on which the trust was established</u>. Hence, the term “Medicaid Pay-Back Trust.” Thereafter, any remaining balance may be paid to other beneficiaries designated in the trust document.

The essential requirements for the (d)(4)(A) trust are as follows:

- The trust must be created by the disabled individual, a parent, grandparent, guardian, or the Court;
- The disabled beneficiary must be less than 65 years of age;
- The assets utilized in the trust must belong to the disabled person;
- Upon the death of the disabled person, the balance remaining in the trust must be paid back to the state or states that rendered public benefits <u>to the extent</u> that each respective state provided such services.

There is no limit on the amount of assets the trust could contain; however, the beneficiary or creator of the trust must be <u>under the age of 65</u>. Note: Child support payments ordered by court may be paid into a (d)(4)(A) trust and do not reduce SSI or Medicaid benefits so long as distributions are not used for food or shelter expenses. Social Security Act, as amended, sections 1612(a)(2) § and 1612(b)(9); 20 CFR 416.1121(b). *See also* 317:35-5-2

Another form of disability trust set forth in the OBRA provisions, is what is called a "pooled-account" trust, set forth in §1396(P)(d)(4)(C). This statute provides that:

- The trust is established and managed by a nonprofit association;

- A separate account is maintained by the nonprofit organization for each beneficiary of the trust, but the trust assets may be pooled for investment and management purposes;
- The accounts in the trust are created solely for the benefit of individuals who are disabled, by the disabled individual, a parent, grandparent, or legal guardian of such individuals, or by a court; and
- To the extent amounts remaining in the beneficiary's account upon the death of the beneficiary are <u>not retained by the trust</u> for charitable purposes, the trust pays to the state from such remaining amounts in the account in an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the state plan. The State of Oklahoma only allows the pooled trust to retain 30% of the balance and the remainder is paid to the State(s) up to the amount corresponding or equal to the amount expended by the State for Medicaid benefits provided to the disabled person. OAC 317:35-4-41.6
- The beneficiary must be under age 65 (via rule of OKDHS, but this "rule" is not contained in the federal statute). Pooled trust companies authorized in Oklahoma are ARCare Trust, Midwest Special Needs Trust and Secured Futures.

X. Taxation Issues with Special Needs Trusts

Due to compressed tax rates for trusts, it is typically better for an individual rather than the trust to bear the income tax liability burden. For a third party trust, during the grantors' lifetime, the trust is likely funded with a nominal amount, which may be held as part of the grantors' other holdings. Usually, with these trusts, they are not fully funded until someone has died (either the parents or grandparents). At the death of the grantor, an EIN must be obtained and an account established for the Trust. These trusts may or may not qualify for favorable tax qualification known as Qualified Disability Trust ("QDT"). QDTs can claim a personal exemption on their federal income tax returns.

- **Qualified Disability Trusts ("QDT")**

A Qualified Disability Trust ("QDT") is, according to the IRS Code, "a disability trust described in subsection (c)(2)(B)(iv) of section 1917 of the Social Security Act (42 U.S.C. 1396p)" and all of whose beneficiaries are "determined by the Commissioner of Social Security to have been disabled (within the meaning of §1614(a)(3) of the Social Security Act, 42 U.S.C. 1382c(a)(3)) for some portion of such year." In 2024, if an SNT meets the requirements to be considered a QDT, it gets a $5,000.00 deduction amount in lieu of a personal exemption. Without this provision, the trust's usual $100 or $300 (depending on whether all income is required to be distributed annually) exemption amount controls.

To qualify as a QDT, the trust must: (1) be irrevocable; (2) be for the sole benefit of a person determined to be disabled pursuant to the Social Security Act; and (3) have a beneficiary who is under 65 years of age.

- **First Party Trusts**

Alternatively, for first party trusts, all trust income is generally reported on the beneficiary's social security number because these are treated as grantor trusts regardless of whether all income is distributed annually. Grantor trust rules are found at IRC §§671-679. However, the Trustee can elect to obtain an EIN and report Trust income separately from the beneficiary if circumstances warrant.

XI. Achieving a Better Life Experience (ABLE) Act—Another Tool in the Special Needs Planners' Toolbox

In February, 2013 a bipartisan set of congressional leaders initiated and proposed a new tool to assist disabled persons with setting aside funds which had been earned, inherited, or awarded, into a special type of account similar to a 529 account. According to the Act, the assets held in such "ABLE" account would not be deemed a resource to the disabled person and thus not disqualify the disabled person from receipt of SSI and or Medicaid. An ABLE account is one that is permitted to be established by a disabled person (or other legal representative) residing in a state that has adopted ABLE statutory provisions as authorized by the Congressional statute. An ABLE account, does not necessarily eliminate the need for creation of a Medicaid pay back trust as discussed earlier in these materials, but may serve the purpose of avoiding the necessity of creating a Medicaid payback trust which otherwise might have to be funded with very small sums.

Oklahoma passed and the governor signed into law our ABLE state act in May of 2016, effective on January 1, 2017. The Oklahoma state treasurer is entrusted with providing implementation and policies, and forms to explain and promote the Oklahoma version of the ABLE act. The State Treasurer's office has implemented the ABLE program in Oklahoma, effective May of 2018 (https://okstable.org). Setting up an ABLE account in Oklahoma requires a minimum opening balance of only $50.00. The annual fee charged by the state is $27.00 effective January 1, 2024. The investment management fee is between 0.19% and 0.33%.

There are certain features of an ABLE account containing specific requirements that must be satisfied and adhered to on an ongoing basis in order to avoid disqualification of either the ABLE account itself, or to avoid disqualifying withdrawals or disbursements made from the account. An ABLE account also has tax advantages for qualified individuals with disabilities.

Earnings on investments in a qualified ABLE account will not be taxed by the IRS. (State income tax rules may apply, however.) Any person may make contributions to an ABLE account including the disabled beneficiary, his or her family and friends. The purpose of the ABLE account is to provide some additional method of saving funds to create for the disabled beneficiary a source of non-disqualifying resources to empower the disabled individual to purchase future medical, recreational, housing or other needs that previously were out of reach of acquisition by the disabled person due to the standard <u>prohibition</u> of accumulating assets or resources *in excess of $2000* pursuant to the SSI and Medicaid rules. A person who is disabled who is seeking to establish an ABLE account must have significant disabilities with an age of onset of those disabilities occurring <u>before the person turns 26 years of age</u>. A person over that age *may* possibly still qualify as long as he or she was able to prove by documentation that the disability existed prior to the person reaching age 26. The disabled individual, or a parent or guardian of the individual, must submit a "disability certification."

"Disability certification" means with respect to an individual, a certification by the individual or the parent or guardian of the individual that:

a. the individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months, or is blind within the meaning of Section 1614(a)(2) of the Social Security Act, and

b. a copy of the individual's diagnosis related to the individual's relevant impairment or impairments, signed by a physician

> meeting the criteria of Section 1861(r)(1) of the Social Security Act, can be provided; …

56 O.S. §4001.1(8)

The total contributions from all sources including the individual, family, and friends is $18,000 per year, unless contributions include wages, then the maximum annual contribution goes up by $14,580 for a total maximum of $32,580.00. *This is the maximum from all sources of donors*. The total limit over time that could be held in an ABLE account in a particular state is limited to the education related code section 529 savings accounts. Some states (like Oklahoma) have set that limit at no more than $450,000 per that state's 529 plan. However for persons who are receiving SSI as well as Medicaid, the ABLE act exempts the first $100,000 in an ABLE account from being considered as a resource for <u>SSI purposes</u>. However if the ABLE account exceeds $100,000 the disabled beneficiary will be suspended from eligibility for SSI benefits and can no longer receive any SSI monthly income. However that same beneficiary will continue to be eligible for Medicaid. The state will likely be able to recoup some Medicaid expenses expended on behalf of the disabled individual after the death of the disabled beneficiary. This is similar to the Medicaid payback trust discussed earlier.

The ABLE account is designed to hold funds and allow those funds to be disbursed for "**qualified disability expenses**" (see Appendix B). These expenses include, but are not limited to, such things as: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative expenses, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses approved under Section 529A of the Internal Revenue Code. The Treasury Department has been entrusted by the Congressional act with establishing and oversight of the ABLE account regulations. As of January 2024, there are 49 ABLE plans nationwide. Many allow non-residents to participate. In addition to allowing means-tested benefits recipients to accumulate resources, and the growth is tax-free, account owners can select from multiple investment plans.

An ABLE account is different from a special needs Medicaid payback trust in certain ways but quite similar in others. With an ABLE account, the account owner [e.g. the disabled individual or his authorized legal representative (defined by the Act as anyone who has Power of Attorney, a conservator or legal guardian, a spouse, parent, sibling, grandparent or representative payee – in that order of priority) will have the ability to control their own funds and establish the account on their own. It is anticipated that the cost of establishing and ABLE account will be significantly less than the cost of creating, or having created for a disabled person, a Medicaid payback trust due to the fact that the state will provide forms, guidance and procedural steps that the disabled person may take to establish an ABLE account. Also, the distributions from an ABLE account are more flexible than those from an SNT because ABLE account funds can be used for housing expenses (including rent, mortgage payments, utilities and property taxes), whereas these would count as income to the beneficiary of an SNT.

Due to the current annual limitation of $18,000 per year from all sources which can be contributed to the ABLE account, an ABLE account will not solve the problem of a person who is receiving SSI and or Medicaid, from continuing to qualify for those benefits if they inherit significant sums of money in excess of $18,000 in a year. However, the ABLE account is a very convenient option for families where parents, grandparents or other donors wish to make smaller gifts for the benefit of a disabled person either outright while living, or by means of a testamentary gift, without destroying the disabled person's public benefits such as SSI and or

Medicaid. This is a very simple and handy option available to disabled persons that did not exist before passage of the ABLE Act.

Even with the passage of the Special Needs Trust Fairness Act, which allowed disabled individuals themselves to establish a Medicaid payback trust, the ABLE account may be of equal or even greater value than the Medicaid payback trust because of the greater control the disabled individual will have over qualifying distributions from an ABLE account versus distributions by a trustee from a Medicaid pay back trust. Also, an eligible individual can participate in the investment choices for the account and, if able to do so, use a debit card to complete transactions. Again however the ABLE account will not displace all circumstances where a Medicaid payback trust may be advisable, due to the limitation in the maximum amount that can be held by an ABLE account, or the slow funding process limited to $18,000 per year [the maximum contribution amount is tied to the annual gift tax exemption amount].

One caveat to note: child support payments made into an ABLE account are considered income for SSI and Medicaid purposes. As a general rule, child support also counts when determining eligibility for Medicaid; but there is a calculation used based on the parents' income. *See* DHS Appendix C-1, Schedule VI. But, child support or alimony paid directly to a trust or trustee because of a court order are considered irrevocably assigned and thus not trust income. POMS SI 1120.200(G)(1)(d) and POMS SI 1120.(j)(1)(d)

Thus, an ABLE account is another tool in the planners' toolbox to assist disabled individuals in accumulating funds for purposes related to an individual's disability thus continuing to have an opportunity to enrich the lives of disabled persons without destroying public benefits.

XII. Conclusion

Although SNT drafting is not overly complex, an understanding of the factors that affect the selection or use of a Supplemental or Special Needs Trust and the choice of wording requires a delicate walk through a legal minefield. The estate planner using this arrangement must obtain adequate understanding of the public benefits law that may affect a choice of estate planning tools normally available to a client. In addition, other family factors and goals of the client, often associated with normal or routine estate planning, are of particular concern when planning for a disabled child or other person, since a special needs person may not be able to adequately advocate on their own behalf or compensate by means of their own earnings for an otherwise poorly planned arrangement.

Aggressive inquiry must be pursued by the estate planner of the client, extended family members and third parties as to whether or not the disabled individual is currently qualified for or receiving public benefits, and if so what type (*i.e.,* SSI, SSDI, etc.), and whether or not any other family member anticipates leaving to the disabled person an outright gift, trust, or anticipated inheritance. Knowledge of this information early on will assist the estate planner in more thorough planning. Sometimes extended family members must be educated substantially as to the danger of their "benevolence" and what harm it will cause to the receipt of public benefits for the disabled person. Thus, an unusually broad picture of the client and his extended family is very important to ensure that an unanticipated inheritance does not cause serious planning problems for the disabled person, or that such an inheritance can be channeled into a Special Needs Trust or other protective device which preserves public benefits while enhancing the quality of life of the beneficiary.

APPENDIX A: Medicaid/Medicare Comparison Chart

WELFARE	INSURANCE
SSI	**SSDI**
Supplemental Security Income **Provides cash only for food, clothing, and shelter expenses** **Requires a showing of disability or medical eligibility**	**a/k/a: Social Security Disability, or disability insurance benefits** **Pays a monthly benefit based on FICA contributions of disabled person (or parent's record, in some cases).** **Must have sufficient quarters ("fully insured")**
MEDICAID	**MEDICARE**
a/k/a "Soonercare" **Purpose: pays doctors, hospital, prescriptions, and other medical providers directly** **Eligibility: requires a separate application with DHS and a determination of disability/medical need, or determination of eligibility for SSI** **Has strict financial limitations as to both income and resources**	**Purpose is to pay doctors, hospitals, prescriptions, etc.** **Must have received SSDI for at least two (2) years before coverage begins (except for special circumstances)**

DUAL ELIGIBILITY
Some individuals get welfare *and* insurance based benefits

APPENDIX B: Qualified Disability Expenses Related to ABLE Account

Qualified Disability Expenses Related to ABLE Account

Qualified disability expenses (QDE)[2] are expenses made for the benefit of the designated beneficiary and related to their disability, including, but not limited to:

- Education;
- Housing;
- Transportation;
- Employment training and support;
- Assistive technology and related services;
- Health;
- Prevention and wellness;
- Financial management and administrative services;
- Legal fees;
- Expenses for ABLE account oversight and monitoring;
- Funeral and burial; and,
- Basic living expenses.

[2] https://www.ssa.gov/ssi/spotlights/spot-able.html