



# Planning for Loved Ones With Special Needs

Program Planner: Donna J. Jackson

Sponsor: Arcadia Trails Addiction Recover

**OBA/CLE DEPARTMENT**

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## **Barb Helm**

Barb Helm is the Executive Director of Arcare, Inc. Arcare is a non-profit corporation offering future planning, guardianship, and financial services to individuals with disabilities and their families. Barb has been in the position of Executive Director for 28 years. Barb holds a degree in social work from the University of Kansas. She is a Licensed Social Worker and a National Certified Guardian. She was instrumental in the development of the Arcare Pooled Trust Program and has been administering the trust since its inception in 1996. The Arcare Trust Program serves over 1000 beneficiaries residing in Kansas, Missouri, Oklahoma, Nebraska and Iowa. Barb is a frequent speaker at community and continuing legal education events speaking on the topics of Planning for a Family Member with a Disability, Special Needs Trusts, and The Arcare Trust Program. Phone - 913-951-3704, email - [barbh@arcare.org](mailto:barbh@arcare.org), Web site - [www.arcare.org](http://www.arcare.org)

## **Donna J. Jackson**

Donna J. Jackson is a nationally recognized attorney, authority, speaker and educator in estate planning. Ms. Jackson is a CPA and holds a Master Degree (LL.M.) in Elder Law. Ms. Jackson has over 29 years of legal experience. She limits her practice to estate planning with an emphasis on Medicaid, VA Benefits and special needs planning, including trusts, special needs trusts, wills, durable power of attorneys and living wills. In addition, Ms. Jackson's practice includes taxes, corporate, trust, individual, gift and estate, probates and business organizations, including corporations, limited partnerships and limited liability companies.



## **Samantha D. Shepherd**

Samantha Shepherd practices exclusively in the areas of Elder Law, Estate Planning, and Special Needs Law. She received her undergraduate degree in 1990 from Tulane University in New Orleans, cum laude. She earned her law degree from Boston College Law School in 1994 and received an LL.M. in Estate Planning from the University of Missouri, Kansas City.

Samantha currently serves on the Board of the National Academy of Elder Law Attorneys. She is a former Chair of the Kansas City Metropolitan Bar Association Trust and Estates Committee, Chair of the Missouri Bar Elder Law Committee and former President of the Missouri Chapter of NAELA. She is an accredited attorney with the Veterans Administration and is Certified as an Elder Law Attorney by the National Elder Law Foundation in both Kansas and Missouri. She is the founder and managing attorney of the firm.

## Mark D. Munson

Attorney Mark D. Munson principally advises clients in the areas of Elder Law, Public Benefits (including Special Needs Trusts), **Estate and Trust Planning, Taxation, Asset Protection, and Medical Assistance Eligibility. He also assists clients with Probate, Estate Administration, and Trust Administration.** Mark is a Certified Elder Law Attorney (CELA) by the National Elder Law Foundation and is **an accredited attorney by the Veterans Administration. Mark is very active within the professional Elder Law community and serves as** member of the board of directors for NAELA and is a past member and current advisor to the board of directors of WI-NAELA. In **addition, he also serves on the steering committee for NAELA's tax section and is a member of its Trusts and Special Needs Trust section. He received a B.S.8 (with distinction) from the University of Minnesota Carlson School of Management and a J.D. from the University of South Dakota School of Law.**

## **Planning for Loved Ones with Special Needs**

Thursday, March 7, 2019  
Oklahoma Bar Center  
1901 N. Lincoln Blvd.  
Oklahoma City, OK 73105

### **Program Planner:**

**Donna J. Jackson, Donna J. Jackson & Associates, PLLC, Oklahoma City**

- 8:30 a.m. Registration (w/ Continental Breakfast)**
- 9:00 a.m. Intro to Special Needs Trusts and Trust Administration**  
Barb Helm  
Arcare of Kansas City and Oklahoma City
- 9:50 a.m. Break**
- 10:00 a.m. cont'd**
- 10:50 a.m. I May Have Dementia, but I'm NOT Incapacitated (ethics)**  
Donna J. Jackson
- 11:40 a.m. Networking Lunch (included in registration)**
- 12:10 p.m. What Every Estate Planner Needs to Know About Special Needs Trusts**  
Samantha Shepherd  
Shepherd Elder Law Group, LLC  
Kansas City, MO
- 1:50 p.m. Break**
- 2:00 p.m. Paying Retirement Benefits to Special Needs Trusts**  
Mark Munson  
Shepherd Elder Law Group, LLC  
Kansas City, MO
- 2:50 p.m. Adjourn**
- Sponsors: Arcadia Trails**



# Special Needs Trusts

*Presented by Barb Helm, LBSW, NCG, Executive Director, Arcare, Inc.*

March 6, 2019

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# Arcare, Inc.

- Established in 1982
- Future care planning services  
Guardianship/Conservatorship
- Special Needs Trust management services – Pooled and Stand-Alone  
Available to OK residents
- Payee services
- Case management services

# Overview of SNT's

- Financial Planning and Estate Planning Tool
- Governed by trust language and applicable statutes
- Protect eligibility for Means tested Programs: SSI, Medicaid and other public benefits
- Provides financial management, protects against exploitation and misuse of funds.

# Why a Special Needs Trust?

## Protects Public Benefits

> \$2,000 ≠ Medicaid/SSI

< \$2,000 = Medicaid/ SSI

Trustee uses complete discretion to **protect** the individual from **exploitation** and **poor decision making**.

# Medicaid: A Quick Primer

- Federal/State Funding Match (varies by program)
- Means tested program subject to –
  - Income limits
  - Asset limits (often called resources)
    - Countable assets
    - Exempt assets
    - Transfer penalties for institutional care/skilled nursing and waiver programs – Meaning you can't give money away!



# Importance of Medicaid for PWD

- Medicaid eligibility presumed with SSI disability determination; 2 year window before Medicare
- Essentially no co-pays or deductibles
- Medicaid covers long term care not covered by Medicare or other medical plans, critically important for PWD
- Comprehensive HCBS waiver programs includes extensive community supports as alternative to facility-based LTC
- Entitlement services with due process & appeals
- Medicare and Medicaid
  - Combined coverage expands provider network
  - In some instances, Medicaid will pay Medicare premiums for QMMBs if it is cost effective for Medicaid

# SSI: A Quick Primer

- Federal Program passed during the Nixon era to supplement income for seniors and PWD
- For PWD without enough eligible SSDI quarters, SSI may be their only income (FY 18 max single benefit \$771/mo)
- Means tested program
  - Income tests and small exclusions
  - Asset limit of \$2000
- Extensive POMS on all aspects of eligibility, income, representative payee, as well as trusts (Program Operation Manual System)
- Only 1% of eligibility cases involve trusts so most Field Office staff are not familiar with trusts, certainly not experts
- Regional Trust Review Process implemented in April, 2014

## OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE OASDI

- Found in Title II of The Social Security Act
- Unlike SSI, SSDI is not a means tested welfare program
- SSDI is an insurance program
- Coverage based on quarters the person paid into SSA while employed
- Person must meet SSA definition of disabled to qualify – same criteria as SSI
- Definition is: “The inability to do any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.”
- Definition for Children under 18, disability is defined as medically determinable physical or mental impairment which results in “marked and severe functional limitations.”

# SSDI – WHO IS ENTITLED

- Disabled wage earner under 65
- Spouse and dependent children, disabled children – called dependent benefit. Persons with disability found disabled before age 22 is eligible for dependent and survivor benefit based on record of parent who is SSDI or SSA recipient.
- “Waiting Period” must establish period of disability for 5 consecutive months.

# MEDICARE

- Medicare is a health insurance program.
- IT is not a means tested program- Medicaid is!

## Eligibility

- People 65 and older who receive Social Security Benefits
- People under age 65 and receiving SSDI or Railroad Retirement Disability Benefits - eligible 24 months after benefits are first received
- People of all ages with End-Stage Renal Failure disease

# HUD HOUSING

- Two types of federal housing programs
- Section 202 – public housing which no longer exists, was merged with voucher program
- Rent Assistance – Section 8 most often relevant to persons with disabilities.
- Section 8 – commonly called the Housing Choice Voucher
- Pays rent subsidies for low income persons/families
- Generally recipient pays 30% of adjusted monthly income for rent

# Other Benefits

- Legislation passed in Dec. 2014
- National Defense Authorization Act of 2015 – NDDA
- Allows for military survivor benefits to be paid into a first party SNT
- Extremely important for PWD because the benefit does not count as income when determining eligibility for Medicaid/spend down or client obligation.



# Federal Authority Protecting Public Benefits

## *Exceptions for Counting Special Needs Trusts as a Resource*

- **SSI**

- Section 1917(d)(4)(A) of the Social Security Act
- Section 1917(d)(4)(C) of the Social Security Act

- **Federal Medicaid Regulations**

- Title 42 US Code Section 1396p(d)(4)(A) *Individual Trust*
- Title 42 US Code Section 1396p(d)(4)(C) *Pooled Trust*

- **Medicaid Transfer Penalties for individuals ≥65**

- State by state determination
- More states applying the penalty
- Oklahoma, Kansas and Missouri all apply penalty



# Types of Special Needs Trusts

- Supplemental Needs Trust – Third-Party Funded  
**Proactive Tool.**
  - A trust created by a third party with the third party's assets which are intended to be used for the beneficiary and will not be considered available for SSI/Medicaid purposes.
  
- Payback Trust, Self Settled, 1<sup>st</sup> Party, Special Needs  
**Reactive Tool**
  - A trust created by a Medicaid/SSI recipient using their own assets. The assets in the trust are not considered available for SSI/Medicaid purposes.
    - Private - (d)(4)(A) – Stand Alone
    - Pooled - (d)(4)(C)

Trust Type	Third Party	1396p(d)(4)(A) 1 <sup>st</sup> party Medicaid Payback OAC 317:35-5-41.6(6)(A)	1396p(d)(4)(C) Pooled 1 <sup>st</sup> party Medicaid Payback OAC 317:35-5-41.6(6)(C)
Established By	Third party – not PWD	Individual, Parent, grandparent, legal guardian, court	Individual, Parent, grandparent, legal guardian, court
Funded By Assets From	Third party	Person w/disability	Person w/disability
Beneficiary	Person w/disability	Sole benefit – only person w/disability	Sole benefit – only person w/disability
Distributions	Payments to 3rd parties	Payments to third parties	Payments to third parties
Medicaid payback?	No	Yes	Yes
Disability	SSA Definition & Determination	SSA Definition & Determination	SSA Definition & Determination
Age Limit	No	Funded before age 65	Varies state to state Ok transfer penalty for 65 and over
Uses	<ul style="list-style-type: none"> <li>•Parent planning for child with disability</li> <li>•Inheritance directed to SNT</li> <li>•Life insurance directed to SNT</li> <li>•IRA directed to SNT w/o</li> </ul>	<ul style="list-style-type: none"> <li>•Personal Injury</li> <li>•Inheritance or life insurance payable to person with disability</li> <li>•IRA w/o penalties per IRS</li> </ul>	<ul style="list-style-type: none"> <li>•Personal Injury</li> <li>•Other court settlements</li> <li>•Inheritance or life insurance payable to person with disability</li> <li>•Retroactive SS benefits</li> </ul>

# Federal Statute Payback Trust

## 42 USC §1396p(d)(4)(A)

- Under age 65
- Assets of the individual with disability
- Must meet SSA standard of disability
- Created by individual, parent, grandparent, guardian or court.
- For the sole benefit of individual
- Supplemental language, discretionary

Payback Provision - The trust must include language that says: to the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the state plan.

# Federal and State Law

- 42 USC §1396p  
(d)(4)(A) vs d(4)(C)
- Oklahoma Health Care Policy  
317:35-5-41.6  
Special Needs Trusts – 3<sup>rd</sup> party
- Exempt Trusts - Payback

# Medicaid Payback Trusts

## 1<sup>st</sup> party

Individual/d(4)(A)	Pooled d(4)(C)
Individually Attorney Drafted Trust Agreement for each specific situation	Master Trust Agreement, beneficiary “joins” the pool by execution of a Joinder Agreement
One Trust Account	The Trust Corpus consists of sub-accounts or trust shares, each for a specific beneficiary
Contributions and disbursement are made to or from one single account	Contributions and disbursement are tracked separately for each sub-account or share
Single investment account managed by trustee or individual investment manager	Assets are pooled for investment management purposes
Can be established by Family Member	Non-Profit Trustee and Administrator

# Trust Fairness Act

- Passed Dec. 13, 2016
- The law corrects an error made more than 23 years ago in the Omnibus Budget Reconciliation Act of 1993
- Prior to passage of the law, person with capacity could not establish a d4a trust, the trusts could only be established for the benefit of the PWD by a parent, grandparent, legal guardian or the court. Unlike the d4c or pooled trust which can be established by the individual, parent, grandparent, legal guardian or court. On Dec. 13, 2016, President Obama signed the 21<sup>st</sup> Century Cures Act (P.L. 114-255). Section 5007 of this law contains the “Fairness in Medicaid Supplemental Needs Trust,” which adds two words “the Individual” to the laws governing 1<sup>st</sup> party SNT’s.

## Pooled Trust Payback Trust 42 USC §1396p(d)(4)(C)

A trust established in a State for the benefit of an individual if:

- (i) The trust is established and managed by a non-profit association
- (ii) A separate account is maintained for each beneficiary of the trust, but, for purposes of investment and management of funds, the trust pools these accounts
- (iii) Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in section 1382c(a)(3) of this title) by the parent, grandparent, or legal guardian of such individuals, by such individuals or by a court.
- (iv) To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this subchapter.

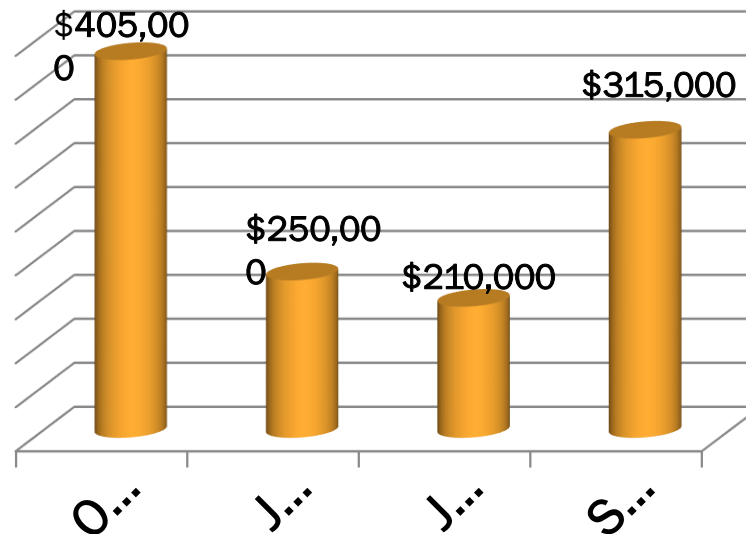
Oklahoma penalizes transfer for persons 65 and older

# POOLED TRUSTS

## What is a Pooled Trust?

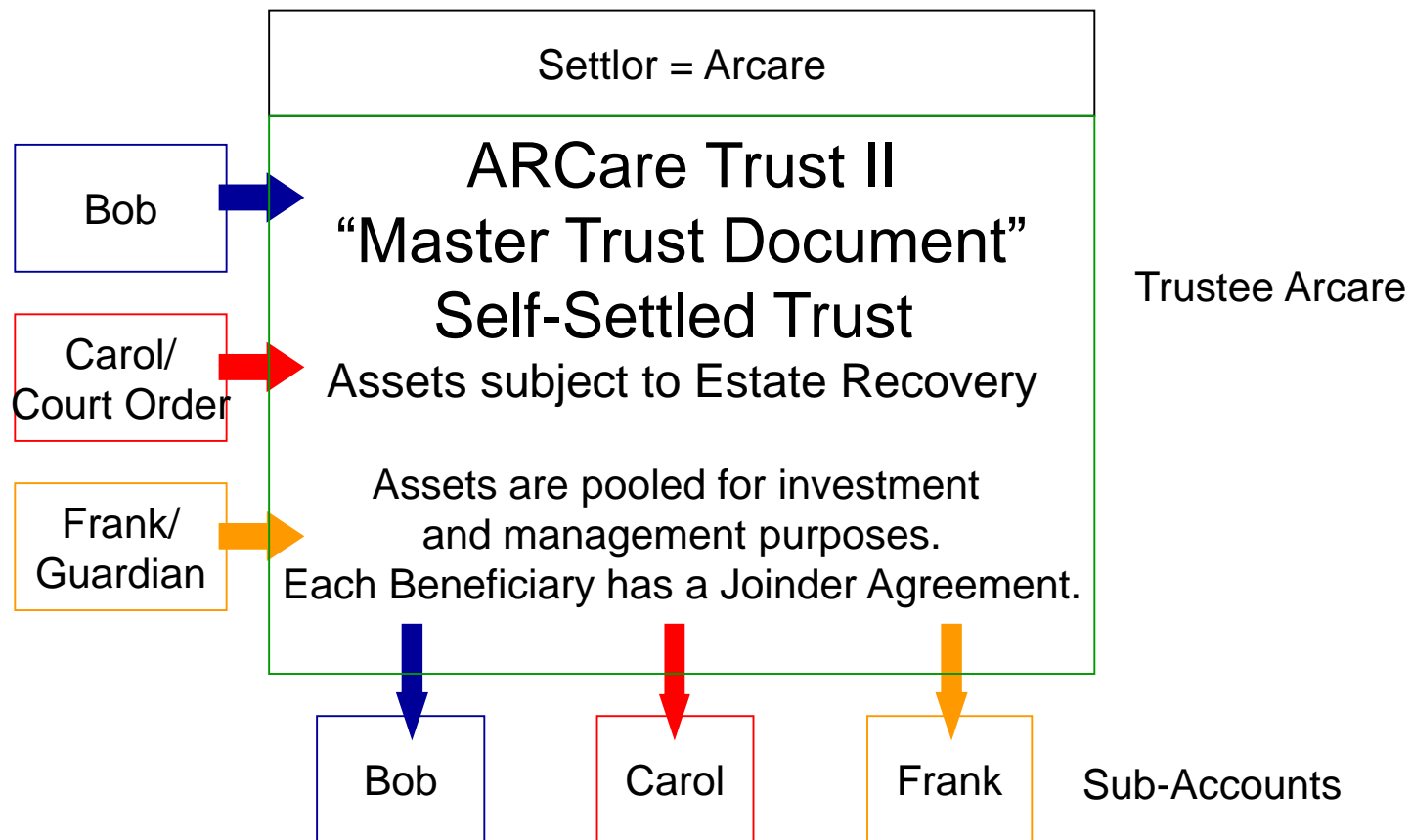
- A Trust consisting of several separate sub-accounts, each for a specific beneficiary

Contributions and disbursements are tracked separately for each **sub-account**





# The Arcare Special Needs Trust II



# Considerations in Establishing a Medicaid Payback Trust

- Over Resourced?
- Recipient of Personal Injury Settlement
- Inheritance
- Back disability benefit payments
- Role of the Representative Payee (GN 00602.075  
Transfer of Benefits to a Trust)
- Benefits preservation
- Other options – ABLE accounts

# Funding the 1<sup>st</sup> Party SNT Medicaid Payback Trust

Funded by Assets from:

Personal Injury Settlement

Prior to Funding:

- State Medicaid Lien must be satisfied from litigation proceeds prior to funding trust.
- Medicare Lien must be satisfied
- Consider if Need exist for Medicare set aside
- Other Medical Liens must be satisfied

# Reporting Requirements When SNT is Funded

- Notify local SSA office if beneficiary is an SSI recipient.
- Send copy of trust document.
- Notify OKDHS if beneficiary is a Medicaid recipient.
- Send copy of joinder agreement and trust document.

# Trust Administration

## 1<sup>st</sup> party trust

- Guidance for administration found in the Social Security Administration's POMS (Program Operations Manual System)
- Source:  
<https://secure.ssa.gov/apps10/poms.nsf/chapterlist!openview&restrictcategory=05>
- Highlights: Payments must be made to third parties, never to the beneficiary themselves
- Distributions must be for sole benefit of the beneficiary
- For Extra and supplemental needs, distributions for food and shelter (ISM) impact SSI

# Federal Requirements for Payback Trusts at Death of Beneficiary

## Pooled Trust Pooled 42 USC § 1396p (d)(4)(C)

To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this subchapter.

## Individual 42 USC § 1396p (d)(4)(A)

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

# Reporting Requirements at Death of Beneficiary

If the beneficiary has received medical assistance through a State Medicaid Plan(s), the Trustee shall notify such agency, or agencies, in writing of the death of the Beneficiary. Notice shall be addressed to the head of every such agency with a copy to the chief counsel of such agency and mailed by certified mail. After payment of expenses pursuant to Sections 9.01(a) and (b), the Trustee shall, upon receipt of a written claim for reimbursement, distribute and deliver to the State(s) Medicaid Plan where the Beneficiary resides or has resided, an amount not to exceed the amount of medical assistance provided by such agency, as reimbursement for medical assistance provided by such agency, paid on behalf of such Beneficiary, even to the point of exhausting the assets of the Trust.

# THIRD PARTY TRUST

- Must be established with funds in which the beneficiary has no ownership, usually funded by parent, grandparent, sibling
- Donor has no duty to support – eliminates parents of minor children and spouses during their lifetime
- Parents of adult children can fund pooled trust while parents are alive or through estate planning
  - Provides an opportunity for PWD, parents, prospective caregivers, other family members to form a relationship with the PT administration
  - Can create another level of support for PWD
  - May result in smoother transition when parents die
  - May alleviate stress between parent and child
  - Not required to be sole benefit
  - Does not require Medicaid payback!



# THIRD PARTY POOLED TRUST

- Master Trust Document
- A Trust consisting of several sub-accounts, each for a specific beneficiary
- Contributions and disbursements are tracked separately for each sub-account
- Assets are pooled for investment and management purposes
- NO PAYBACK
- Remainder Beneficiaries are named in joinder agreement

# SPECIAL NEEDS TRUST ADMINISTRATION

## FACTORS TO CONSIDER IN TRUSTEE SELECTION

- Knowledge and Relationship with person with disability
- Costs
- Level of service
  - Case management
  - Legal expenses to defend the trust
  - Amendments to comply with changes in federal requirements
  - Will trustee hold non-cash assets in the SNT?
- Knowledge of public benefit programs, community resource, distribution rules and impact on benefits, reporting requirements.

## SNT TRUSTEE'S BASIC DUTIES

- Consistent with purpose of trust to supplement public benefits & enhance the beneficiary's quality of life
- Prudently invest and protect trust assets
- Authorize distributions while making funds last as long as practicable
- Work with the beneficiary's guardian or conservator, if one has been appointed
- Stay current with applicable SSI and Medicaid income and resource rules so trust assets and distributions do not adversely affect beneficiary eligibility
- Keep accurate records, reply to eligibility requests and file necessary federal and state tax returns
- Report regularly to beneficiary and other interested parties
- Defend the trust if necessary at a reasonable cost
- Terminate the trust and distribute assets consistent with the terms of the trust and applicable federal and state laws and regulations

# Distributions from an SNT

## The Dos (payments must be made to a vendor)

- Advocacy services
- **Pre-Paid** Burial Expenses of beneficiary
- Cable television
- Camp tuition
- Clothing for the Beneficiary
- Computer hardware and software
- Curtains, towels, linens, decorative items
- Education, tuition, books or transportation to same
- Entertainment and recreation tickets
- Equipment (electronic, entertainment, adaptive)
- Expenses related to owning and operating one car
- Eyeglasses
- Furniture and household items
- Gardening and lawn care
- Guardianship and advocacy services
- Home appliances
- Home renovations to improve accessibility
- Homeowner insurance premiums
- Independent evaluations
- Insurance premiums (health, dental, life, care and renter)
- Internet access
- Job coaching
- Legal fees
- Magazine subscriptions
- Medical equipment
- Medical, nursing and dental care, not covered by another source
- Medications
- Massage therapy
- Office supplies
- Personal assistance
- Pet care and supplies
- Private counseling and case management
- Private lessons and materials
- Stamps and writing supplies
- Supplemental dietary needs
- Telephone service
- Testing (vocational, medical, psychological, etc.)
- Vacation expenses including transportation and hotel

# Distributions from an SNT

## The Don'ts (or at least try not to)

- Don't distribute cash directly to the beneficiary.
- Discourage payments for food or shelter if the bene is and SSI recipient – in kind support and maintenance (This includes rent, gas, electric, water and waste disposal.)

# Impact of ISM Distributions

## **Example:**

Tom receives SSI. He lives in an apartment by himself. The trustee of a Pooled Trust makes a one-time rent payment of \$350 for Tom. According to SSA regulations, shelter is considered ISM and will be counted as income and reduce his SSI benefit by 1/3 for that month.

# In-Kind Support and Maintenance

## **In-Kind Support and Maintenance Defined – SI 0835.310**

- “In-kind income includes ISM (i.e., food, and shelter) and other noncash items that the claimant uses to obtain food, clothing and shelter.”

## **Shelter Defined – 20 CFR 416.1130**

- “Shelter includes room, rent, mortgage payments, real property taxes, heating fuel, gas, electricity, water, sewerage, and garbage collection services.”

# Impact of ISM Distributions

## **Example:**

Tom lives in an apartment by himself. The trustee of a Pooled Trust makes a one-time rent payment of \$350 for Tom. According to SSA regulations, shelter is considered ISM and will be counted as income and reduce his SSI benefit by 1/3 for that month.



# Impact of Unearned Income on SSI Beneficiary

- Cash distributed directly to SSI beneficiary
  - First \$20.00 of any income disregarded.
  - After that, unearned income will reduce SSI dollar for dollar.

# Alternatives to Special Needs Trusts

- Spend down the money to purchase needed exempt assets
  - Home or home repairs/improvements, vehicle, or pre-paid funeral/burial plan
  - Compliant with POMS & state Medicaid requirements
  - Payment of loan or debt accumulated by the beneficiary
- Pre-pay expenses for a reasonable time period
  - Rent, utilities, insurance premiums or home warranty
  - Needed hygiene or care supplies not covered by Medicaid
- Lose Medicaid eligibility until money is spent below asset limits
- ABL Accounts – onset of disability prior to age 26
  - Similar to 529 Plans but specifically for persons with disabilities
  - An account that protects assets for purposes of qualifying for Medicaid and SSI
  - Review law & limitations carefully interpreted in SSA POMS & IRS rules

# Pooled Trust Benefits

- Trust is already established
- Professional Trustee – only serves persons with disabilities – KNOWLEDGE of organization!
- Accepts smaller amounts of money
- Fees are generally lower than for profit trustee
- Relieves family members of responsibility and possible conflicts between members, also conflicts of interest.
- Provides ongoing stability in administration
- Many PT organizations also provide additional services.
- Vital component of care plan which brings - Peace of Mind

**“Experience is generally  
worth the price no matter  
how dearly bought.”**

*-Unknown*





# Questions?

Contact Barb Helm, Executive Director, Arcare, Inc.

Phone: 913.951.3704

[barbh@arcare.org](mailto:barbh@arcare.org)

[www.arcare.org](http://www.arcare.org)

# **I Have Dementia, But I am Not Incapacitated:**

## **Ethics in the Practice of Elder Law**

**By Donna J. Jackson, LLM**

The practice of elder law presents a myriad of ethical dilemmas. Counseling clients who are potentially vulnerable due to age, disability, or incapacity requires attorneys practicing in elder law to keep strict ethical standards to ensure their client's needs are protected while appropriately maintaining the client's autonomy and independence as much as possible. Although there are numerous, conceivable ethical predicaments, this article will specifically address the attorney's ethical duty in: identifying who the attorney's client is and providing proper service to that client, appropriately handling any conflicts of interests that may arise in representation in the practice of elder law, and the representation of incapacitated clients.

### **Identifying Who Your Client Is**

Aging, disability, and incapacity are a family affair. It is not uncommon for clients needing the assistance of an elder law attorney to have family members involved in the process as well. Sometimes these family members are even the ones setting appointments and driving the client to meet with the attorney. Even if there is no attorney-client relationship formed with certain parties involved in the initial client meeting, attorneys still owe a duty of confidentiality and avoidance of conflicts to every prospective client.<sup>1</sup> Although rule 1.18 of the Professional Rules of Conduct's definition of a prospective client as one "who discusses with an attorney the possibility of forming an attorney-client relationship with respect to a matter"<sup>2</sup> is fairly vague, courts have often said that the existence of an attorney-client relationship is determined by the reasonable belief of the client.<sup>3</sup> Therefore, an attorney must assume that everyone sitting at the table believes the attorney is their attorney, making it crucial to identify who the actual client is early on and asserting to those involved who the client is.

Because of the familial nature of the practice of elder law, identifying the client begins with the initial scheduling of an appointment. When a person calls to set up an appointment, it is important to identify: who the caller is, who documents will be created for, who will be present at the initial meeting, and what the role each of those present at the initial meeting will be playing. Although one must ask the general nature of the legal help needed during the initial appointment scheduling, one should avoid talking about specific details of the representation and giving any legal advice—as the caller may not be the client.

At the initial meeting, it is important for the attorney to identify who the most likely client is. Although comments to Rule 1.7 of the Rules of Professional Conduct state "common

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<sup>1</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.18 (2008).

<sup>2</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.18(a) (2008).

<sup>3</sup> Grace Giesel, *The Attorney-Client Relationship in the Age of Technology*, 32 Miss. C. L. Rev. 319, 322 (2013).

representation is permissible where the clients are generally aligned in interest even though there is some difference of interest among them”, scholars argue that single representation provides for better client protection and lowers the risk for conflicts of interests.<sup>4</sup> For example, a child’s interest in protecting his or her inheritance may interfere with an elder client’s wishes involving Medicaid planning, and “it is the [elder] who [would] need[] long-term care and whose finances [would be] under consideration.”<sup>5</sup> Thus, some important questions to ask during the initial scheduling and/or appointment may be who is establishing the trust or writing a will, or whose money is at issue in tax or Medicaid planning. Ultimately, the question of who the client is “must be resolved before an attorney agrees to represent” anyone.<sup>6</sup>

### **Addressing Conflicts of Interest**

Although family members may be involved in assisting their loved one, or the attorney may be representing clients jointly, it is important the attorney avoids any conflicts of interests. Determining who the client is upfront and communicating that to the family will help the attorney mitigate potential conflicts of interests in the beginning of representation. After the attorney identifies who the client is, it is best to ask to speak to the client privately. Upon speaking to the client privately, the attorney can further determine whether he or she has any existing conflicts of interests and allow the client to share confidential information with the attorney.<sup>7</sup>

If an attorney represents clients jointly however, the attorney must take extra steps to ensure that all clients involved understand how the joint representation will operate. For example, although it may be normal for a couple to seek estate planning services together, it is important they know certain conflicts may arise that could hinder the attorney’s ability to appropriately represent both clients. Rule 1.7 of the Rules of Professional Conduct explains that an attorney may represent a client as long as the representation will not “be directly adverse to another client; or there is [not] a significant risk that the representation of one or more clients will be materially limited by the [attorney’s] responsibilities to another client.”<sup>8</sup> However, if a conflict of interest does arise during the representation that materially affects the attorney’s duty to either client, the attorney must withdraw representation.<sup>9</sup>

Beyond the issue of family members assisting their loved one in obtaining an elder law attorney and accompanying them to the meetings, a family member may also pay for the

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<sup>4</sup> See David Rosenfeld, *Whose Decision is it Anyway?: Identifying the Medicaid Planning Client*, 6 Elder L.J. 383 (1999), Mark Falk, *Ethical Considerations in Representing the Elderly*, 36 S.D. L. Rev. 54 (1991), Patricia Rumore, *Elder Law: Pitfalls for the Unwary*, 58 Ala. Law. 160 (1997).

<sup>5</sup> David Rosenfeld, *Whose Decision is it Anyway?: Identifying the Medicaid Planning Client*, 6 Elder L.J. 383, 389 (1999).

<sup>6</sup> Mark Falk, *Ethical Considerations in Representing the Elderly*, 36 S.D. L. Rev. 54, 62 (1991).

<sup>7</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.7, .8, .9, .18 (2008).

<sup>8</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.7(a) (2008).

<sup>9</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.16(a)(1) (2008).

attorney's fees. When that third party pays the attorney's fees directly, there are special rules an attorney must follow to avoid any conflicts of interest.<sup>10</sup> Although the family member may want to be involved in helping his or her loved one, it is important the attorney explain that he or she only represents the client.<sup>11</sup> Furthermore, the person paying the attorney's fee must understand that the client sets the objectives of representation, and information from the client must be kept confidential by the attorney outside of certain extreme circumstances.<sup>12</sup> It is also important to assure the client that he or she sets the objectives of the representation and information from the client will be kept confidential.<sup>13</sup> After explaining this to the person paying and the client, the attorney must obtain informed consent from the client in writing.<sup>14</sup> These mandatory precautions ensure the attorney's independence in judgment and protection of the client and his or her wishes.

### **Clients with Diminished Capacity**

“As individuals age, they face an increased likelihood of diminished capacity, which can pose significant challenges in establishing and engaging in attorney-client relationships.”<sup>15</sup> In fact, in 2010 approximately 4.7 million people ages sixty-five and older were living with Alzheimer's disease in the United States, with that number estimated to increase over the years.<sup>16</sup> Capacity may also be diminished because of minority, mind altering substances, disability, or some other mental or physical illness.<sup>17</sup> Although diminished capacity is not certain, it is likely the elder law attorney will have a question about advising a client with diminished capacity at some point during his or her career.

In determining the capacity of a client, the comments to rule 1.14 of the Rules of Professional Conduct give a list of factors for the attorney to consider: “the client's ability to articulate reasoning leading to a decision, variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client.”<sup>18</sup> It may also be helpful for the attorney to obtain information or verify information a client has given the attorney by speaking to third parties. Although an attorney may not disclose information from the client<sup>19</sup>,

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<sup>10</sup> See Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.8(f) (2008).

<sup>11</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.8(f)(2) (2008).

<sup>12</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.2, .4, .8 (2008).

<sup>13</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.2, .4, .8 (2008).

<sup>14</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.8 (2008).

<sup>15</sup> Thomas Stasi, *Reform that Understands our Seniors: How Interdisciplinary Services can Help Solve the Capacity Riddle in Elder Law*, 45 U. Mich. J.L. Reform 695, 695 (2012).

<sup>16</sup> Liesi Hebert, Jennifer Weuve, Paul Scherr, & Denis Evans, *Alzheimer Disease in the United States (2010–2050) estimated using the 2010 census*, 80 Neurology 1778, 1778 (2013).

<sup>17</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(a) (2008).

<sup>18</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14 cmt. 6 (2008).

<sup>19</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(c) (2008).



the attorney may want to listen to what others have to say when working with clients that have declining capacity so as to help gauge a client's capacity.

Despite a client having diminished capacity, rule 1.14 of the Rules of Professional Conduct directs the attorney to “maintain a normal client-[attorney] relationship with the client” “as far as reasonably possible.”<sup>20</sup> This normal relationship, the comments to rule 1.14 explains, “is based on the assumption that the client...is capable of making decisions about important matters.”<sup>21</sup> Although maintaining this normal relationship may not be possible with “severely incapacitated person[s]”, who have “no power to make legally binding decisions[.]...a client with diminished capacity often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being.”<sup>22</sup> Regardless, the attorney always has an “obligation to treat” client's with diminished capacity “with attention and respect.”<sup>23</sup>

The comments to rule 1.14 of the Rules of Professional Conduct further suggest that under certain circumstances, “the [attorney] may seek guidance from an appropriate diagnostician” if there are concerns about diminished capacity.<sup>24</sup> In situations where the attorney is reasonably concerned the client with diminished capacity “is at risk of substantial physical, financial or other harm...and cannot adequately act in the client's own interest,” the attorney is permitted to take “reasonably necessary protective action.”<sup>25</sup> Protective action may include “consulting with... [those who]...have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator, or guardian.”<sup>26</sup> However, when taking protective action, the attorney must be careful in considering whether disclosure of information about the client's capacity to certain persons will result in those persons acting “adversely to the client's interests.”<sup>27</sup> Ultimately, the attorney should support the client in making his or own decisions as much as the attorney can.

Although the practice of elder law involves peculiar ethical issues, an attorney who has a system in place to deal with these challenges can ethically and proficiently represent clients that are potentially vulnerable due to age, disability, or incapacity. At the core of an elder law attorney's ethics should be the desire to advance his or her client's rights of independence and autonomy. By appropriately identifying who the client is in the initial stages of representation, addressing any potential conflicts of interests upfront, and always treating the client with

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<sup>20</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(a) (2008).

<sup>21</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14 cmt. 1 (2008).

<sup>22</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14 cmt. 1 (2008).

<sup>23</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14 cmt. 2 (2008).

<sup>24</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14 cmt. 6 (2008).

<sup>25</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(b) (2008).

<sup>26</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(b) (2008).

<sup>27</sup> Okla. Stat. tit. 5, Ch. 1, App. 3-A, R. 1.14(c), cmt. 8 (2008).

attention and respect—no matter the client’s capacity, the elder law attorney can ethically advocate for his or her client.

# PLANNING FOR LOVED ONES WITH SPECIAL NEEDS: A Case Study

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OKLAHOMA CITY, MARCH 6, 2019

# Bob's Story: The sad beginning

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Bob Howard is a third generation farmer. Bob is involved in a serious accident at age **55** and needs a nursing home. The injury is so severe that Bob is not able to talk, walk, or feed himself. Bob needs Medicaid (Soonercare) to pay for his care.

# Bob's Story: SoonerCare needed

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Bob's assets exceed \$2000, so you conclude that Bob would benefit from a Special Needs Trust so that he can qualify for SoonerCare immediately.

**Question: Is Bob's physical and mental condition severe enough to establish a SNT:**

**Answer: Yes. Bob is unable to engage in any substantial gainful activity by reason of a mental or physical impairment 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 12 months.**

**Question: What is the maximum age for establishing a SNT?**

**Answer: up to age 65**

**Question: Who should establish the SNT on Howard's behalf?**

**Answer: Bob's mother, father, grandparents OR Bob's guardian OR a court Or Bob**

# Bob's Story: Guardian needed

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Bob's son has been appointed as Bob's legal guardian. Bob's father is still alive and in good health.

**Question: Does this change your decision about who can establish Bob's SNT?**

**Answer: Yes. Either Bob's son (Bob's legal guardian) or Bob's father are the likely candidates to establish the SNT. Bob can not establish his own trust, as he does not have capacity.**

# Bob's SNT Trustee: Who?

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**Bob's children, parents, or grandparents can serve as Bob's trustee.**

**A special needs attorney or a trust company can also serve as Bob's trustee.**

**Trust Company/Bank**

**Individual with SNT experience, such as attorney acting as fiduciary.**

**NOT individual who may be a remainder beneficiary.**

**NOT an inexperienced professional.**

**NOT a bank unwilling to learn individual beneficiary's needs (Matter of JP Morgan Chase Bank N.A.)**

# What Provisions Should be in Bob's SNT?

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Hybrid Standard Distribution: Document reflects it is within the trustee's discretion and consistent with the trust purpose to pay for food and shelter, resulting in a deliberate reduction of SSI.

Spendthrift Provision: This provision prohibits involuntary and voluntary transfer of beneficiary's interest in trust income or principal. This provision should prevent assignment of the interest.

Settlor's Intent: Always include language reflecting the settlor's intent regarding the disability of the beneficiary and maintaining benefit eligibility.



# 5 Key Issues for Bob's SNT

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**Irrevocable:** The trust should be irrevocable.

**Distribution Standards:** Not support, not HEMS (Health, Education, Maintenance and Support), not ascertainable standard.

**Trustee-Name:** Someone with SNT experience. It's a job.

**Payback Provision:** Bob's trust is funded with Bob's farm and Bob's money. Bob's trust is FIRST PARTY. 1<sup>st</sup> party trust requires a payback to SoonerCare. BOB's needs a payback provision.

**Sole Benefit:** Only for beneficiary's benefit.

# Bob's Story: A happy ending?

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After a year in a specialized rehabilitation nursing home, Bob has improved to such an extent that both he and his family believe that Bob now has the ability to live independently.

**Question: What things that the attorney should consider?**

**Answer: We should consider whether Bob now has sufficient capacity so that we can terminate the guardianship. We should also explore MONEY FOLLOWS THE PERSON, a program that provides community-based support.**

# NOW....JEOPARDY!!

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Extra facts:

**Bob has a Grampa Joe, who wants to leave him money.**

**Bob has a work history. He will receive SSDI and not SSI.**

**Bob's owns a farm.**

# Questions?

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**THE TAXATION OF SPECIAL NEEDS TRUSTS:**  
**WHAT EVERY SPECIAL NEEDS LAW ATTORNEY NEEDS TO KNOW**  
2019 OKLAHOMA BAR ASSOCIATION, OKLAHOMA CITY, OK

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**TAXATION OF SPECIAL NEEDS TRUSTS**

I. Self-Settled Special Needs Trusts – Trusts funded with assets of the settlor (i.e., the special needs individual) for the benefit of the settlor.

A. Types of Self-Settled Special Needs Trusts

1. 42 U.S.C. § 1396p(d)(4)(A)
2. 42 U.S.C. § 1396p(d)(4)(B) – “Miller” trusts
3. 42 U.S.C. § 1396p(d)(4)(C) – pooled trusts

B. Funding Self-Settled Special Needs Trusts

1. Income Tax – Contributions to a self-settled special needs trust by the settlor, or someone on the settlor’s behalf (i.e., guardian, parent, court, etc.), are income tax neutral (no income tax consequences to the donor [settlor] and no income tax consequences to the donee [trustee/trust]). See Internal Revenue Code (“IRC”) §§ 102 and 1015 regarding income tax treatment of gifts (e.g., “carry-over basis” applies). Also, for reasons discussed below, grantor trust treatment will apply.

2. Gift Tax

a. Generally, contributions to a self-settled special needs trust by the settlor, or someone on the settlor’s behalf (i.e., guardian, parent, court, etc.), are incomplete gifts for gift tax purposes because trust assets are reachable by the settlor’s general creditors under the laws of most states (no spendthrift protection for settlors of self-settled trusts). See IRC § 2511 regarding completed gifts for gift tax purposes and Revenue Ruling 77-378.

b. Contributions to a self-settled special needs trust by the settlor, or someone on the settlor's behalf, may be a completed gift for gift tax purposes if distributions are in the discretion of an independent trustee and trust assets are not reachable by general creditors pursuant to the law of the state governing the trust (analogous to the domestic asset protection trust (or, "DAPT") analysis). See *Herzog v. Commissioner*, 116 F.2d 591 (2d Cir. 1941) and Revenue Rulings 76-103 and 77-378. Note: A completed gift for gift tax purposes may not be a completed gift for estate tax purposes (i.e., inclusion of the trust assets in the gross estate for estate tax purposes could still result). See PLR 9837007. See also Chief Counsel Memorandum ("CCM") 201208026.

c. There is an argument that a contribution by the settlor to the trustee of a self-settled special needs trust is not a gift (because the settlor receives valuable consideration in return). Please see *Sullivan v. Schultz (In re Schultz)*, 368 B.R. 832 (Bankr.D.Minn 2007).

### C. Administration of Self-Settled Special Needs Trusts

#### 1. Income Tax

a. Inter Vivos - Grantor trust rules apply during settlor's lifetime. See IRC §§ 671 - 679.

(i) Settlor – The settlor must report all of the trust's income, losses, deductions and credits on settlor's individual income tax return. See IRC §§ 673 and 677. It may also be advisable to include a IRC § 675(4)(C) power to substitute assets of equivalent value to insure grantor trust status and to provide flexibility to the settlor (or the settlor's legal representative) for future estate planning.

(ii) Trustee – The trustee should comply with Treas. Reg. § 1.671-4(b), which sets forth three alternatives for reporting grantor trust income tax information to the IRS.

b. Post-Mortem – Traditional fiduciary income taxation rules regarding trusts apply (simple versus complex trusts, distributable net income, etc.). Generally, see IRC §§ 641 – 668. The trustee will need to prepare and file fiduciary income tax returns (IRS Form 1041 along with supporting forms and schedules and, if applicable, state forms and schedules).

2. Gift and Estate Tax – Gift and estate taxes should not be applicable to the administration of self-settled special needs trusts since trust distributions should be to the settlor or on the settlor's behalf.

D. Distributions from Self-Settled Special Needs Trusts

1. Income Tax

a. Inter Vivos – No income tax consequences to the settlor/beneficiary for receipt of a distribution or for a distribution made on the settlor’s behalf, and no income tax consequences to the trustee (due to application of the grantor trust rules). Distributions from a self-settled special needs trust to the settlor/beneficiary, or someone on the settlor/beneficiary’s behalf, are income tax neutral.

b. Post-Mortem – Application of traditional fiduciary income tax rules for trusts (distributable net income (“DNI”), etc.). See I.C.1.b. above.

2. Gift and Estate Tax – Gift and estate taxes should not be applicable to distributions from self-settled special needs trusts since trust distributions should be back to the settlor or on the settlor’s behalf.

E. Termination of Self-Settled Special Needs Trusts – This outline assumes that termination occurs due to the settlor’s death as opposed to exhaustion of trust assets during the settlor’s lifetime.

1. Income Tax – Grantor trust rules become inapplicable upon the death of the settlor and traditional rules of fiduciary income taxation apply.

2. Estate Tax – Assets in a self-settled special needs trust will be included in the settlor’s gross estate for estate tax purposes upon the settlor’s death. See IRC §§ 2033 and 2036. “Stepped up” basis will be realized. See IRC § 1014.

II. Third-Party Supplemental Needs Trusts – Trusts funded with the assets of someone other than the trust’s primary beneficiary (typically, an individual with special needs who may be eligible for Medicaid and other governmental entitlements).

A. Inter Vivos or Testamentary

1. Inter Vivos

a. Grantor Trust – The settlor must decide whether an inter vivos third-party supplemental needs trust should be a grantor trust (which can be either a revocable trust or an irrevocable trust) or a non-grantor trust (which must be an irrevocable trust) as to the settlor during the settlor’s lifetime.

(i) A **revocable** third-party supplemental needs trust will be a grantor trust as to the settlor (see IRC § 676), will not qualify as a taxable gift for gift tax purposes (see IRC § 2511; still available to settlor’s creditors and still within the settlors “dominion and control”), and will be included in the settlor’s gross estate for estate tax purposes upon the settlor’s death (see §§ IRC Sec. 2036 and 2038) with qualifying assets receiving a stepped-up basis at that time (see § IRC Sec. 1014).

(ii) An **irrevocable** trust can be structured so that it is either a grantor trust, a non-grantor trust, or both.

i. There is a transfer tax planning benefit if the settlor is responsible for paying income taxes generated by trust assets if the initial transfer constitutes a completed gift for gift tax purposes (i.e., more wealth can be pushed through transfer tax free when the settlor is responsible for paying income tax on trust’s income if there is a completed gift upon transfer to the trust and the trust property will not be included in the settlor’s gross estate upon death). See Revenue Ruling 2004-64 (no gift to trust beneficiary or beneficiaries for gift tax purposes if settlor pays income tax on income from trust assets due to grantor trust status).

ii. Although it would be quite desirable for income tax purposes, it is not recommended to create grantor trust status as to the primary beneficiary due to probable loss and/or ineligibility of Medicaid and other public benefits. See IRC § 678.

b. Non-Grantor Trust – To be an inter vivos non-grantor trust, the third-party supplemental needs trust must be irrevocable.

(i) Does the settlor want to be responsible for reporting income and paying income tax on money that is no longer for the settlor’s benefit? Can the settlor afford to pay income tax on income if the settlor has no legal access to the trust assets? But, see Revenue Ruling 2004-64 (the trust can contain a provision for the trust to pay the settlor’s income tax liability attributable to trust’s income without causing estate tax inclusion in the settlor’s gross estate; this would be best structured if an independent and nonadverse trustee has discretion to make such distributions to the settlor).



(ii) Traditional fiduciary income tax rules apply. Please see IRC §§ 641 – 668.

i. It is important to remember that trust fiduciary income tax brackets are significantly compressed when compared to individual income tax brackets. In 2019, the top income tax rate of 37% starts at only \$12,750 for trusts and at \$518,388 for a single individual and at \$ for married couples.

ii. The Qualified Disability Trust, which provides an increased personal exemption and is discussed more thoroughly later in this outline, should be considered if the third-party supplemental needs trust will have non-grantor trust status.

c. Complete Gift – Does the settlor want the gift to the third-party supplemental needs trust to be a completed gift for gift tax purposes? See IRC § 2511 and Treas. Regs. §§ 25.2511-2(b) and (c). Is missing out on “stepped up” basis and being stuck with “carryover” basis the right decision? See IRC §§ 1014 and 1015.

d. Incomplete Gift - Does the settlor want the trust property included in her gross estate for estate tax purposes to realize “stepped up” basis? See generally §§ 2033 and 1014.

2. Testamentary – Traditional rules governing fiduciary income taxation of trusts will apply. See I.C.1.b above and II.C.1.a.(ii) below.

3. Non-Tax Considerations – Generally, non-tax considerations are more important than tax issues when planning for and drafting the third-party supplemental needs trust, including the decision whether the trust should be created during the settlor’s lifetime or upon the settlor’s death. Non-tax considerations include funding by others, being able to revoke or amend the trust due to changing circumstances and/or laws (i.e., the decision to use an inter vivos revocable trust versus an inter vivos irrevocable trust), compliance with Medicaid and other public assistance laws, being better able to handle non-probate distributions (such as life insurance and retirement benefits), the settlor’s overall asset protection and estate planning goals and objectives, and to witness the relationship between the trust and the primary beneficiary and the impact the trust has on the primary beneficiary’s quality of life. Finally, trust provisions to provide flexibility to deal with unforeseen tax and non-tax issues should be considered and, if appropriate, drafted into the third-party supplement needs trust. Trust provisions that provide flexibility to deal with changing circumstances include trust protectors, trust advisors, committees to remove and replace trustees, allowance for changes of trust situs and governing law, and allowance for decanting.

B. Funding Third-Party Supplemental Special Needs Trusts

1. Income Tax

a. Inter Vivos

(i) Grantor Trust – No income tax consequences to the settlor or to the trustee. See IRC §§ 671-679.

(ii) Non-Grantor Trust – No income tax consequences to the settlor or to the trustee. See IRC §§ 102 and 1015.

b. Testamentary – No special income tax rules or consequences when funding a testamentary third-party supplemental needs trust. Same as funding any other type of testamentary trust.

2. Gift Tax

a. Incomplete Gift – No gift tax issues. Gifts to a trust are incomplete for gift tax purposes if the trust is revocable or if the trust is irrevocable and the settlor retains certain powers over the trust and/or its assets (such as a limited/special power of appointment). See IRC § 2511 and Treas. Regs. §§ 25.2511-2(b) and (c). But, see § 2511(c) for transfers to a trust after December 31, 2009.

b. Complete Gift

(i) No “Crummey” Withdrawal Right – Completed gifts for gift tax purposes to an irrevocable trust are gifts of a future interest to the trust beneficiary or beneficiaries. As a result, gifts to an irrevocable trust are not eligible for the annual exclusion. See IRC § 2503(b). As a result, the donor will be required to prepare and file a gift tax return (IRS Form 709). Note: The current annual exclusion amount is \$15,000.

(ii) “Crummey” Withdrawal Right – The existence of a “Crummey” withdrawal right transforms a completed gift to an irrevocable trust from a gift of a future interest to a gift of a present interest, which, in turn, makes the annual exclusion available to the donor. See IRC § 2503(b) and *Crummey v. Commissioner*, 397 F.2d 82 (9<sup>th</sup> Cir. 1968). As a result, the donor may be able to avoid filing a gift tax return. Filing a gift tax return may still be advisable to start the statute of limitations if the donor is likely to have a taxable estate.

(iii) Limitation of “Crummey” Withdrawal Right – The “Crummey” withdrawal right should not be given to the primary beneficiary of the third-party supplemental needs trust if Medicaid eligibility is an issue because of the Medicaid asset limitation and asset transfer rules. However, “Crummey” withdrawal rights can be given to parties who have legitimate interests in the trust as either income or remainder beneficiaries. See *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991) (but, be careful of “naked Crummey” withdrawal rights; see IRS Technical Advice Memorandum 9628004). It is ideal to structure

“Crummey” withdrawal rights so that they are limited to the “five by five” power (i.e., the “Crummey withdrawal right should be limited to the greater of \$5,000 or 5% of the trust assets) or designed as “hanging powers.” See IRC §§ 2514(e) and 2041(b)(2). Otherwise, certain gift tax and generation-skipping transfer tax consequences will result as to the “Crummey” withdrawal beneficiary or beneficiaries. Careful attention should be given to all applicable tax laws when using “Crummey” withdrawal rights, including income tax (grantor trust rules). The settlor can be given the power to vary the identity of who receives the “Crummey” withdrawal right on an annual basis without causing inclusion of trust assets in the settlor’s gross estate for estate tax purposes. See PLRs 9834004 and 9030005.

### C. Administration of Third-Party Supplemental Needs Trusts

#### 1. Income Tax

##### a. Inter Vivos

(i) Grantor Trust – All income, losses, deductions and credits taxed back to the settlor as if trust does not exist. Trustee has some income tax compliance responsibilities. See I.C.1.a.(ii) above.

(ii) Non-Grantor Trust – Traditional fiduciary income tax rules for trusts apply, including simple versus complex trust structure, distributable net income (“DNI”), trust principal and income allocation issues for tax and non-tax considerations, no deduction for expenses attributable to tax-exempt income (such as municipal bonds), and fiduciary investment fees subject to 2% of the trust’s adjusted gross income or “AGI” (see the *Knight v. Commissioner*, U.S. \_\_\_\_, 128 S. Ct. (2008) and IRS Notices 2008-116 and 2008-32). See I.C.1.b. above. It is worth noting that an irrevocable third-party supplemental needs trust may qualify as a “**Qualified Disability Trust**” (which provides an increased personal exemption of \$4,150 for 2019 [same as an individual] when compared to \$100 for complex trust or \$300 for a simple trust). See IRC § 642(b)(2)(C).

b. Qualified Disability Trusts – Qualified Disability Trusts have higher personal exemptions (\$4,150 for 2019) than simple trusts (\$300) and complex trusts (\$100). See IRC § 642(b)(2)(C). The income tax brackets for Qualified Disability Trusts are the same as the income tax brackets for simple and complex trusts (i.e., very compressed). A third-party supplemental needs trust will qualify as a Qualified Disability Trust if it meets the following requirements:

(i) Irrevocable – The third-party supplemental needs trust must be irrevocable and cannot be revocable because grantor trust status will be realized. See IRC § 676. However, as noted above, an irrevocable third-party supplemental needs trust can be either inter vivos or testamentary.

(ii) Non-Grantor Trust – The trust must be subject to the general rules of fiduciary income taxation and the trustee must be required to prepare and file fiduciary income tax returns (e.g., IRS Form 1041 along with supporting forms and schedules

and, if applicable, state forms and schedules). It is important to note that if an irrevocable inter vivos third-party supplemental needs trust is created by the primary beneficiary's parents, the parents want to be co-trustees of the trust, and Qualified Disability Trust status is desired, the trust must be carefully drafted so that the parents do not possess any powers that would create grantor trust status.

(iii) Sole Benefit – The trust must be for the sole benefit of an individual who is under age 65. See IRC § 642(b)(2)(C)(ii)(I) with a cross reference to 42 U.S.C. § 1396p(c)(2)(B)(iv). The Social Security Administration defines “sole benefit” to mean “if no other person or entity can benefit from the transferred resources at the time of the transfer or for the remainder of that persons’ life.” See POMS SI 01150.120.B.8. It is unknown at this time whether the IRS would take this narrow of a view in interpreting the term “sole benefit.”

(iv) Disability – The primary beneficiary of the third-party supplemental needs trust must be disabled as that term is defined at 42 U.S.C. § 1382c(a)(3). See § IRC 642(b)(2)(C)(ii)(II). Generally, an individual will be considered to be disabled if the individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which as lasted or can be expected to last for a continuous period of not less than twelve months. See 42 U.S.C. § 1382c(a)(3)(A). See also 42 U.S.C. § 1382c(a)(3)(B).

c. Testamentary – Traditional fiduciary income tax rules for trusts apply. See II.C.1.a.(ii) above.

2. Gift and Estate Tax – Not applicable to the general administration of third-party supplemental needs trusts.

#### D. Distributions From Third-Party Supplemental Needs Trusts

##### 1. Income Tax

###### a. Inter Vivos

(i) Grantor Trust – See I.C.1.a. above

(ii) Non-Grantor Trust – See II.C.1.a.(ii) above

b. Testamentary – See II.C.1.a.(ii) above.

2. Gift Tax – A completed gift for gift tax purposes occurs if a distribution is made to a beneficiary and there was no completed gift for gift tax purposes when the assets were contributed (e.g., settlor retains a limited/special power of appointment over trust assets). See IRC § 2511.

E. Termination of Third-Party Supplemental Needs Trusts – Typically, a third party supplemental needs trust will be drafted so that it terminates upon the primary beneficiary’s death. Usually, the primary beneficiary’s death will occur after the settlor’s death, but not always.

1. Income Tax

a. Settlor Dies Before Primary Beneficiary

(i) Grantor Trust – Grantor trust status terminates upon the death of the settlor and traditional fiduciary income tax rules for trusts apply.

(ii) Non-Grantor Trust – Continuation of traditional fiduciary income tax rules for trusts.

b. Primary Beneficiary Dies Before Settlor

(i) Grantor Trust – Grantor trust status continues until trust is terminated or the settlor dies.

(ii) Non-Grantor Trust – Continuation of traditional fiduciary income tax rules for trusts.

2. Gift Tax

a. Settlor Dies Before Primary Beneficiary

(i) Complete Gift – If there was a complete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences when the settlor dies (but, there may be estate tax consequences as to the settlor; very unlikely, however).

(ii) Incomplete Gift – If there was an incomplete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences to the settlor upon the settlor’s death (but, the trust assets will have to be included in the settlor’s gross estate for estate tax purposes and would receive a “stepped up” basis).

b. Primary Beneficiary Dies Before Settlor

(i) Complete Gift – If there was a complete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be no gift tax consequences to the settlor if the primary beneficiary predeceases the settlor. The trust will continue for the benefit of or terminate in favor of its remainder beneficiary or beneficiaries. Again, it may be possible for the trust assets to be included in the settlor’s gross estate for estate tax purposes, but the likelihood of this is very remote.

(ii) Incomplete Gift – If there was an incomplete gift for gift tax purposes by the settlor when assets were contributed to the third-party supplemental needs trust, there will be gift tax consequences to the settlor if the trust terminates or continues and later distributes assets to a beneficiary or beneficiaries other than the settlor during the settlor's lifetime. See IRC § 2511.

### 3. Estate Tax

a. Settlor Dies Before The Primary Beneficiary – If the settlor of a third-party supplemental needs trust dies before the primary beneficiary, the assets will be included in the settlor's estate for estate tax purposes if the settlor retains certain powers over the trust assets, such as the power to revoke (see IRC § 2038), the power to designate beneficiaries (see IRC § 2036), the power to benefit from the trust (see IRC § 2036), the power to make trust property available to the settlor's general creditors (see IRC §§ 2036 and 2038), inter alia. Generally, see IRC § 2033. If trust assets are included in the settlor's estate for estate tax purposes, the trust assets will receive a "stepped up" basis. See IRC § 1014. When drafting the third-party supplemental needs trust, it is important to consider the tax planning options and alternatives that may be available to the primary beneficiary (which may be exercisable by the primary beneficiary, her agent, his conservator, or her guardian). It is also important to consider the non-tax issues with this type of planning, especially the Medicaid and public assistance eligibility, asset transfer, and estate recovery laws.

b. Primary Beneficiary Dies Before The Settlor – In most circumstances, special needs trusts are drafted so that trust assets will not be included in the primary beneficiary's gross estate for estate tax purposes upon the primary beneficiary's death due to Medicaid and estate recovery concerns. An interesting transfer tax planning opportunity presents itself if the assets of a third-party supplemental needs trust can be included in the primary beneficiary's gross estate for estate tax purposes (and generation-skipping transfer tax purposes) while avoiding Medicaid eligibility issues and estate recovery. For example, consider the application and utilization of IRC § 2041(a)(3) ("the Delaware tax trap"). If the trust is drafted so that trust assets will be included in the primary beneficiary's gross estate for estate tax purposes and the settlor survives, the settlor will be deemed to have made a completed gift for gift tax purposes to the primary beneficiary upon the primary beneficiary's death if there was no completed gift upon the settlor's initial transfer to the trust. See IRC § 2511.

### III. Final Considerations

A. Planning with Retirement Benefits – Self-settled special needs trusts can be used to “stretch-out” distributions from an inherited retirement benefit, such as an individual retirement account (“IRA”), in order to preserve maximum income tax deferral of the inherited retirement benefit. See PLR 200620025. Additionally, third-party supplemental needs trusts can be drafted to receive distributions from retirement benefits over the primary beneficiary’s life expectancy in order to preserve maximum income tax deferral of the inherited retirement benefit. If retirement benefits will be paid to either type of special needs trust and “stretch-out” treatment is desired, special provisions must be included in the trust, which should be drafted as a “qualified accumulation trust”, as opposed to a “conduit trust”, in order to protect the primary beneficiary’s needs-based public benefits. To have an accumulation trust qualify as a “Designated Beneficiary” under the Internal Revenue Code (see § IRC 401(a)(9)(E)) and its corresponding regulations (so that “stretch-out” treatment can be realized), there are restrictions on who may be beneficiaries of the trust. Generally, see Chapter 6 of Natalie Choate’s fantastic book entitled “Life and Death Planning for Retirement Benefits, 7<sup>th</sup> Edition 2011.” Retirement benefit “qualified accumulation trusts” have the advantage of “stretching-out” distributions from the retirement benefit over the primary beneficiary’s life expectancy for the purpose of maximizing the deferral of income taxes, but have the disadvantage of the compressed trust income tax brackets (although a Qualified Disability Trust may be able to provide some relief due to its generous personal exemption).

#### B. Professional Issues with Tax Planning and Return Preparation

1. IRS Circular 230; and
2. IRC § 6694 Preparer Penalties and Notice 2008-13.