Top 15 Tips for Estate Planners When Planning *for* Special Needs

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The world of special needs planning has come of age. Once considered a narrow specialty that rarely demanded much of a traditional estate planner's time, understanding how to protect the eligibility of a client's child with a disability for publicly available programs, including health care, is now essential. A topic once reserved for continuing legal education programs involving Medicaid planning for the elderly, the hottest topic today at many estate planning CLEs concerns special needs trusts (SNTs) and special needs planning.

Readers should recall the primary differences between "first-party" SNTs and "third-party" SNTs, as outlined in recent *Probate & Property* articles on the subject. "First-party" SNTs are authorized by 42 U.S.C. § 1396p(d)(4)(A) and (C), related Social Security Administration rules and regulations (known as "POMS," that is, Program Operations Manual System), occasional parallel state statutes, and provisions of state Medicaid manuals. These SNTs are funded with assets owned by the SNT beneficiary, or to which the beneficiary is legally entitled, and must be established by specified settlors, that is, the beneficiary's legal guardian/conservator; the beneficiary's parent or grandparent, either (1) via a "seed trust" initially funded with nominal assets provided by the parent or grandparent or (2) under independent legal authority over the beneficiary's assets other

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than a power of attorney; or a court or other entity. A first-party SNT must be irrevocable and for the sole benefit of a beneficiary under age 65 who is "disabled" within the meaning of 42 U.S.C. § 1382c(a)(3)(A) of the Social Security Act when the SNT is established and funded. On the death of the beneficiary, any assets then remaining in a first-party SNT are subject to a "payback" in favor of all state Medicaid agencies that have provided medical assistance to the beneficiary during his lifetime equal to the total amount of such benefits, even if the payback exhausts the remaining assets of the SNT. In contrast, "third-party" SNTs are funded with assets that do not belong to the beneficiary. Third-party SNTs are not subject to any of the foregoing restrictions and limitations other than that the beneficiary must not be able to revoke or terminate the SNT, nor have the legal authority to direct the use of the SNT assets for his support and maintenance.

First-party and third-party SNTs that are fully compliant with relevant federal and state law, and properly administered by the trustee, will not disqualify the SNT beneficiary from receiving any means-tested government benefits, such as Medicaid and Supplemental Security Income (SSI), for which the beneficiary would otherwise be eligible as a result of his disabilities. Government benefit entitlements based on a person's employment record (for example, Medicare and Social Security Disability Income (SSDI)) are similarly unaffected by SNTs. (See chart on page 40 for a brief comparison of means-tested and employment-based government benefits.)

The list below represents some of the most frequently encountered issues in advising clients who wish to secure the future of a beneficiary with a disability. For ease of reference, the balance of this article often refers to the beneficiary of the SNT as a "child," but the beneficiary may certainly be any person whom the client may wish to benefit under his estate plan.

1. Don't disinherit the child with special needs.

Parents should establish a third-party created and funded SNT for the child's benefit. This should be a purely discretionary trust with precatory supplemental needs language. No Internal Revenue Code (IRC) § 2041 or any other support standard should be included. This approach is highly recommended to avoid disqualifying the child from receiving means-tested government benefits, such as Medicaid and Supplemental Security Income (SSI). This type of SNT may be established as a stand-alone document (the authors' preferred approach) or as part of a parent's or other relative's will. Please note that if a spouse has the disability, federal regulations specify that the spouse without a disability must establish the SNT under a will. An SNT established for a spouse under a living trust will not be effective.

The other four options available for a beneficiary with special needs are *not* recommended. These include (1) distributing assets outright to the child with special needs (the assets may disqualify the child from eligibility for Medicaid and SSI); (2) disinheriting the special needs beneficiary (the beneficiary will have no "safety net" if government benefits are subsequently reduced or eliminated); (3) leaving property to another family member with the "understanding" that the property will be used for the child (this arrangement is not legally enforceable and the recipient's creditors, such as a potential ex-spouse, may be able to seize the assets); and (4) ignoring the situation and doing postmortem planning with a self-settled first-party SNT for the child (a Medicaid payback provision will be required in the SNT). Keep in mind the self-settled approach, however, for estate administration situations in which proper special needs planning was not done and the child with a disability will otherwise lose SSI or Medicaid.

2. Carefully consider the division of assets among the children.

Also consider the allocation of administrative expenses and taxes among the shares of the beneficiaries of the estate and/or trust(s). If parents have created a stand-alone, third-party SNT during their lives, or if they have a testamentary SNT, include a tax apportionment provision in the parents' estate plan and indicate whether or not federal or state estate taxes attributable to the inclusion of the SNT in the estate of the deceased parent should be charged against the SNT.

Often parents will prefer to shift a larger portion of the assets to the share of the child with special needs. Depending on the ages of the other children, common apportionment percentages for a family with one child with special needs and two "typical" children include 50/25/25 and 40/30/30. Other options include an equal division of the assets, while supplementing the share of the child with special needs with a second-to-die life insurance policy paid directly to the SNT. In the situation in which the child with a disability is well-provided for through a first-party SNT established as part of a personal injury settlement, the shares of the typical children may be the largest.

3. Understand the differences among Medicare, Medicaid, Supplemental Security Income (SSI), and Social Security Disability Income (SSDI).

It is possible for a special needs child to receive benefits from all four programs. Each of these public benefits has different eligibility rules and different sets of covered services. SSDI and Medicare are not based on financial need, and SSI and Medicaid have strict financial requirements. Understanding the eligibility requirements of the particular programs for which the child presently qualifies, or is likely to qualify for in the future, is critical for the estate planner to make effective recommendations.

For an individual with a significant work history before the disability, with sufficient sources of health insurance through Medicare and other supplemental means, an SNT may not be appropriate. By contrast, a child in a Medicaid facility who becomes a beneficiary of a standard support trust may lose his or her housing if the support trust is not legally reformed into a first-party SNT. It is easy to confuse the government programs because the

names sound very similar. And do not assume the parents of the child will understand the eligibility differences or can even name the programs for which the child presently qualifies. Always ask to see current documentation from Social Security, Medicare, and Medicaid to verify. Fortunately, several new legal treatises discuss the differences among these programs for just these purposes. By purchasing several of these and subscribing to special needs planning newsletters and e-mail listservs of attorneys practicing in this area, the intricacies of federal and state benefits eligibility regulations will begin to make sense.

4. Choose the trustee of the SNT carefully.

The trustee will be given sole and absolute discretion to make distributions. Family members are generally a poor choice, unless they work with a professional or corporate co-trustee. The trustee should (1) understand and respond to the needs of the special needs child; (2) have a thorough knowledge of government benefit programs and the effect that trust distributions will have on the child's government benefits; (3) be honest and reliable; (4) possess financial acumen; (5) have no conflict of interest (that is, should not serve alone and be a current or remainder beneficiary); and (6) not cause the loss of section 8 housing eligibility (a family member serving alone as trustee often results in the loss of section 8).

5. Parents should prepare a letter of intent to assist the trustee of the SNT.

The letter of intent serves as a blueprint that provides valuable information concerning the daily life and health care concerns of the child with special needs. This is especially important when a new caregiver has to step in to manage the child's day-to-day activities. The letter of intent also describes the child's unique likes, dislikes, needs, preferences, and other important information concerning the child—all of which is helpful to the trustee and the child's caregiver. Several SNT administration treatises, as well as special needs organizations and life insurance companies, provide sample letter of intent forms that provide a starting point for the many parents who want to do this.

6. Include contingent special needs provisions in clients' estate planning documents.

These contingent provisions should deal with the possibility of a future beneficiary having special needs or a disability that is unknown when the document is prepared. The will or trust should include a provision that permits the fiduciary to establish a third-party SNT and to fund it with property that would otherwise be paid outright or to a support trust for the (now) disabled beneficiary. A possible alternative is to give the trustee the power to appoint (that is, decant) the trust assets to another trust that will preserve the beneficiary's eligibility for means-tested government benefits. Because the effectiveness of such state law provisions varies, this language should be carefully considered. Some special needs planning attorneys include a contingent special needs trust as part of a facility of payment provision.

7. Include special language in a parent's revocable living trust.

This language should permit the trustee to make discretionary, nonsupport distributions to or for the benefit of a child with special needs during a parent's own period of incapacity. On the parent's death, the share of the child with special needs would be distributed to a third-party

Overview of Social Security's Kingdom of Benefits

Entitlements Based on Work History (not subject to financial limits)

Monthly Cash Payments			Health Care Coverage Benefits
	SSDI	**MEDICARE**	
	Social Security Disability. Amount received based on work record. Available also to spouse, minor children, and adult disabled children.	Major medical. No prescription coverage. No long-term care after 1st 100 days.	
	SSI	**MEDICAID**	
	Maximum payment of: $674 per month as of 1/1/09 through 12/31/10. Eligibility for SSI in 36 states automatically makes a person eligible for Medicaid, housing assistance, and so on.	Much more comprehensive than Medicare. Covers most medical costs including prescriptions and long-term residential care, but not dental or eye care.	

Means-Tested Benefits
(Work history not required, but very strict limits on income and resources)

created and funded SNT. The following is sample language to consider, along with the applicable state Medicaid regulations, in drafting a provision of this type:

> During any period that I am incapacitated or incompetent, if a child of mine has a disability and is receiving Medicaid, SSI, or other government benefits (or would otherwise be eligible for such benefits), the Trustee may, in its sole, absolute, and uncontrolled discretion, distribute to or apply for the benefit of my child with a disability such amounts of the trust's income and principal as the Trustee shall determine. The Trustee shall have the absolute right to refuse to make any distribution to or for the benefit of my child with a disability, and neither the child nor any representative of the child shall have the right to demand any such distribution from the Trustee. Such distributions by the Trustee shall supplement (and not supplant) such government benefits received by my child. In no event shall my child or his or her spouse serve as a trustee, nor shall the Trustee delegate any of Trustee's powers to my child or his or her spouse.

8. Include special language in a parent's general durable power of attorney.

This language should permit the agent to make discretionary, nonsupport distributions to or for the benefit of a child with special needs and to establish an SNT for the benefit of the child. Consider the following sample language:

> If a child of mine has a disability and is receiving Medicaid, SSI, or other government benefits (or would otherwise be eligible for such benefits), my Agent shall have the power to pay to or apply for the benefit of my child such amounts as my Agent, in my Agent's sole, absolute, and uncontrolled discretion, may from time to time determine desirable for my child's use and benefit. My Agent shall have the absolute right to refuse to make any payment to or for the benefit of my child, and neither my child nor any representative of my child shall have the right to demand any such distribution from my Agent. Payments by my Agent shall supplement (and not supplant) government benefits received by my child. In addition, my Agent may establish and fund with my assets an inter-vivos third-party discretionary nonsupport special needs trust with spendthrift provisions for the benefit of my child with a disability during his or her lifetime, and upon such child's death, the trust residue shall be distributed consistent with my [describe the particular estate planning document].

9. Parents should review all of their assets and beneficiary designations.

It is important to make sure no funds or resources pass directly to the child with special needs and that all of his or her share of inherited property passes directly to the SNT. If assets pass outright to the child with special needs, SSI, Medicaid, and other means-tested government benefits could be lost. Assets to review for beneficiary designations include (1) IRA, 401(k), and other retirement benefits; (2) life insurance; (3) employer-provided death benefits, including life insurance, final paycheck and vacation pay, and so on; (4) accidental death and travel insurance benefits provided through credit cards when a person purchases a plane ticket, and so on, using that credit card; (5) annuities; (6) savings bonds; (7) any other nonprobate property of the parents such as payable-on-death, transfer-on-death, or joint-with-right-of-survivorship accounts; (8) Uniform Transfers to Minors Act accounts; and (9) state homestead laws, if applicable. For example, Florida law, in certain circumstances, gives a vested remainder interest in homestead property.

10. Consider life insurance as a funding method for the SNT.

A cash value building, second-to-die policy that pays on the death of both parents is often very affordable and may be one of the most cost-effective and least expensive ways to ensure that a child with special needs benefits from an amply funded SNT. But, if the life insurance is owned by an irrevocable life insurance trust (ILIT) that includes SNT provisions for a child with a disability, make sure that the child does not have a *Crummey* withdrawal right over premium payments or gifts made to the ILIT during periods when he or she is receiving means-tested public benefits. The existence of the withdrawal right, whether exercised or not, may be viewed by Social Security or a state Medicaid agency as an asset of the beneficiary. Instead, consider including the child's siblings as *Crummey* beneficiaries, and as remainder beneficiaries and contingent or secondary income beneficiaries (to the extent that all current income is not applied by the trustee for the benefit of the child with a disability).

11. Retirement plan assets may not work well.

IRAs, 401(k)s, and 403(b)s, among others, are probably the most inefficient method of funding an SNT. Nevertheless, if retirement benefits must be paid to the SNT, do not include a conduit trust payment provision, as the required minimum annual distribution that would flow outright to the child with special needs would negatively affect his means-tested public benefits. Instead, make sure that the retirement benefits can be *accumulated* inside the SNT, and limit the age of the SNT's oldest possible beneficiary, which must be an individual. To assure a stretch payout, avoid the temptation to include powers of appointment for older beneficiaries or charities or other nondesignated beneficiaries. Care also should be taken to avoid the punitive five-year payout rule, if possible. See Sebastian V. Grassi Jr. & Nancy H. Welber, *Estate Planning with Retirement Benefits for a Special Needs Child, Part 1—Understanding Retirement Plan Distribution Rules*, Prob. & Prop., July/August 2009, at 28.

12. Coordinate other relatives' estate planning documents with the parents' third-party SNT.

Fortunately, a parent's stand-alone, third-party created and funded SNT can be structured to receive lifetime

gifts, as well as inheritances from grandparents and other relatives or friends for the benefit of the child with special needs. This avoids other family members' having to prepare a separate SNT. A letter from the estate planning attorney to the clients after the documents are in place can provide interested family members with the precise verbiage to reference the stand-alone SNT. A provision like the following could be added to the relative's estate planning documents:

> *Special Provisions Concerning Distribution of Property to a Relative with a Disability.* If any property would otherwise be distributable to my granddaughter, whose name is Jane Doe, my fiduciary shall not distribute the property to my granddaughter (or to her guardian or conservator), but shall instead distribute the property to the then acting trustee of The Jane Doe Third-Party Special Needs Trust dated December 1, 2009, to be held, administered, and distributed in accordance with the terms of such trust.

13. Don't forget the estate plan of a child with a disability and of any unmarried sibling of the child.

Consider using a first-party, self-settled SNT for the assets of the child with a disability when means-tested benefits like SSI and Medicaid must be preserved but the assets of the child exceed the eligibility resource limit. The first-party SNT must be carefully prepared under 42 U.S.C. § 1396p(d)(4)(A) or (C) and the SSI Resource provisions of Social Security's Program Operations Manual System (POMS) found at www.ssa.gov/app510/poms.nsf/aboutpoms. Also consider a general durable power of attorney and a health care directive for the child if he or she has the requisite capacity to execute them. Once the child with special needs becomes an adult, a parent's right to know, monitor, advocate, and intercede in the child's affairs may be limited or prohibited without the child's consent, a court order (such as a guardianship), or a power of attorney. The power of attorney of a competent child with a disability should authorize the agent to take the action necessary to join a special needs pooled account trust or to transfer assets to a first-party self-settled SNT.

Consider an advance directive for health care with HIPAA authorization. The HIPAA privacy rules can have horrendous implications for the medical care of an *adult* special needs child if he or she becomes unable to give informed consent or to knowingly participate in his or her own medical treatment. If the special needs child is mentally competent, prepare a health care power of attorney that includes HIPAA release information and names each parent as a "personal representative" under the HIPAA rules so that a parent can legally request and receive confidential medical information. If the special needs child is mentally incompetent, it is often necessary to establish a guardianship for purposes of making his or her medical treatment decisions.

Each unmarried adult sibling of a special needs child should execute an estate plan, because the child with special needs would likely be an heir of the sibling and could receive an outright inheritance from the sibling's estate if the sibling died without a will.

14. What if the parent requires or may soon need nursing home Medicaid?

In preparing an estate plan for parents of a child with a disability, when Medicaid eligibility for the parents could conceivably be necessary, consider having the parents execute special limited powers of attorney authorizing the agent under their powers of attorney, or the trustees of their living trusts, to create and fund a "sole benefit" trust for the child. In an important provision of OBRA'93, a parent seeking his own Medicaid eligibility may be able to avoid the transfer of asset penalty by transferring assets to (1) his disabled child, (2) a trust "solely for the benefit of" the (parent's) disabled child, regardless of the child's age, or (3) a trust for the sole benefit of any other disabled beneficiary under 65, regardless of the relationship to the settlor.

This important exception to the transfer of resources penalty is found at 42 U.S.C. § 1396p(c)(2)(B)(iii) and (iv). The ability to take advantage of this exception has become more important for both parent and child in light of the asset transfer penalty set forth in the Deficit Reduction Act of 2005. Be advised, however, that virtually all (c)(2)(B)(iii) sole benefit trusts will be evaluated by the applicable state's Medicaid agency and subject to close scrutiny. This area is not for beginners. In fact, only one of the authors regularly uses this technique. Similarly, it is helpful for the parent to execute a limited power of attorney expressly authorizing the agent to create and fund a (c)(2)(B)(iv) trust.

15. Obtain a court order directing that child support be paid to a self-settled, first-party SNT.

If the parents of the child with a disability are divorcing, be sure the court enters an order directing that the child's support be paid to a first-party, self-settled SNT, so that means-tested government benefits continue at full rates instead of being offset by the child support amount. Divorce attorneys do not always know how child support payments made directly to a custodial parent interact with means-tested government benefit programs like SSI and Medicaid, or that these unintended consequences can be avoided with a few careful steps. The solution is for the divorce decree to order the noncustodial parent to make payments of a set amount to the custodial parent as trustee of a carefully drafted, self-settled SNT for the sole benefit of that child. Alternatively, an irrevocable assignment by the custodial parent of the child support to the trustee of a trust of this type may also work. Payments ordered to be made in this manner do not displace SSI, greatly benefiting both parents and the child.

Although these tips are not a comprehensive list of all planning considerations, they may suggest ways to improve planning for clients trying to secure the future of a family member challenged by special needs. Take advantage of the increasingly frequent opportunities to learn the nuances of this new "hot" practice area. Your clients will love you for it. ■

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