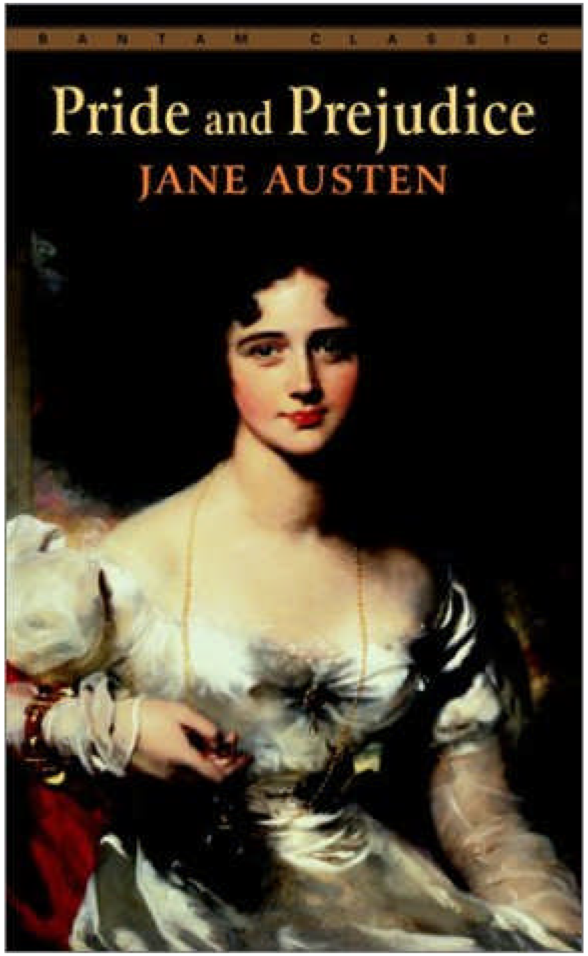
Special Needs Trusts
Risks and Compliance

Frances A. Fata

MB Financial Bank, N.A.

ffata@mbfinancial.com


BANTAM CLASSIC
Pride and Prejudice
JANE AUSTEN

In this session we will discuss the use of Special Needs Trusts to address the needs of a growing disabled population. Beginning with a review of the basics, we will move to identifying risks associated with Special Needs Trusts and share effective strategies for managing these risks.

The Basics

• The purpose of a Special Needs Trust is to preserve eligibility for means-tested government benefits while providing for the supplemental needs of the person with a disability.

•Primary public/government benefits to be preserved are:

- •Supplemental Security Income (SSI)
- •Medicaid (Services and Health Insurance)

More Basics

- Social Security Income, whether Supplemental Security Income (SSI) or Social Security Disability Income (SSDI), is intended to provide **basic support** for food and shelter.

- Special Needs Trusts are intended to provide for the "extras" that go beyond basic support needs.

- Special Needs Trusts work to preserve eligibility for **Medicaid and SSI**, but are not needed to preserve eligibility for SSDI and Medicare.

Types of Special Needs Trusts (SNT's)

- Third-party SNT's are funded with other people's money, such as a relative of a person with disabilities.
- Self-settled "Payback" SNT's are funded with a disabled person's own money. aka "OBRA" trusts
- "Pooled" Payback SNT's are funded with a disabled person's own money which is deposited along with other pooled funds by signing a "joinder" agreement.

Today's discussion will focus on Third-party SNT's and Self-Settled "Payback" SNT's.

Essential Administration of SNT’s

- Manage and invest the trust property
- Make distributions for the beneficiary with a disability in accordance with the trust purpose
- Report the trust to appropriate government agencies including the IRS, Medicaid and Social Security Administration
- Maintain eligibility for government benefits

What is appropriate administration of SNT's in light of recent Court decisions?

- Duty with regard to investigating government benefits

- Duty with regard to determining a beneficiary's special needs and supplementing "the basics"

How can a Trustee effectively manage these affirmative duties?

Risk #1: Failure to Identify a Special Needs Trust

Scenario: Following an acquisition, the Trust department "inherited" a book of Trust business which did not receive the level of scrutiny that would normally occur during a Trust acceptance process. At a recent Committee meeting, staff determined that a Trust that was being administered as a resulting trust with ordinary discretionary powers was, in fact, a Special Needs Trust.

Uh-oh.

Risk #1: Failure to Identify a Special Needs Trust

Compliance Technique #1:

READ THE DOCUMENT!

- Employ staff with subject-matter expertise
- Perform prompt and appropriate Due Diligence on acquired books of business
- Develop coding unique to Special Needs Trusts to more easily distinguish them from other trusts

Key Trust Provisions

- Third Party SNT's:
- Specifies its purpose is to "**Supplement and not Supplant**" municipal, county, state and federal benefits.
- Trustee has **broad discretionary** authority. May contain detailed lists of permitted expenditures, but estate planners differ on whether this is effective.
- Ability to **Amend** the trust to permit the beneficiary to qualify for benefits, and other purposes.
- Discretion to make **disqualifying distributions** as the circumstances may warrant.

•Self-Settled SNT's:

•Specifies its purpose is to "**Supplement and not Supplant**" municipal, county, state and federal benefits.

•**Irrevocable**

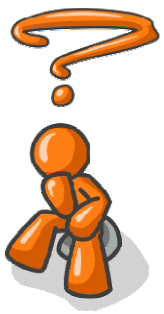
•Distributions are for the **sole benefit** of the beneficiary.

•Beneficiary must be **disabled** and under the age of 65 when the Trust is established and funded.

•**Payback**: Medicaid must be reimbursed for total assistance provided to beneficiary during lifetime.

Risk #2: Failure to Identify Available Benefits for the Disabled Beneficiary

Scenario: The Trustee is managing a Special Needs Trust for a person with disabilities who resides in a Medicaid facility and receives basic care. The facility is not in contact with the Trustee about the beneficiary's needs, and the beneficiary's family is either not involved in the beneficiary's life, or has pre-deceased the beneficiary. The Trustee is doing a great job managing the Trust assets, but isn't there more to be done for the beneficiary?



Risk #2: Failure to Identify Available Benefits for the Disabled Beneficiary

Compliance Technique: The Trustee should visit the beneficiary in order to develop some level of actual knowledge of the beneficiary's needs. Also, provided the SNT permits the Trustee to do so, the Trustee should employ an **advocate** to investigate and assist in making application for benefits that may be available for the beneficiary. The advocate should also provide regular reports to update the fiduciary regarding the beneficiary and assist the Trustee to **identify special needs** that may enhance the beneficiary's quality of life.

Sample Special Needs Trust Language-Advocates

"The trustee is authorized to appoint an Advocate for JOHN DOE for the express purpose of assisting the trustee in evaluating and obtaining any and all benefits of any and all public and private programs providing personal and health care maintenance, residence, support and education to and for persons with disabilities, such as JOHN DOE, to which he may be or becomes entitled and in determining and evaluating such services as may be appropriate for JOHN DOE's welfare not otherwise available from other sources. Further, the trustee shall, with the assistance of said Advocate, exercise every reasonable effort to assure that the benefits of such programs are collected, expended and accounted for separately and apart from any Trust hereinabove provided, and not commingled with said Trust at any time. Said Advocate shall be compensated from trust assets his, her or its usual and customary fee for such rendered services."

Do not accept appointment as SNT without this type of language.

Risk #3: Improper Distributions from a Special Needs Trust

Scenario: The beneficiary of a self-settled SNT requests a distribution to finance a Disney vacation with multiple family members. The beneficiary, while cognitively disabled, is able to travel and is thrilled to be visiting the Magic Kingdom. The Trustee sends a deposit to the beneficiary's personal checking account for $5,000.00 to be used towards the trip. The beneficiary provides receipts for the purchases.

Concerns?

Risk #3: Improper Distributions from a Special Needs Trust

- Distributions from a self-settled SNT must be made for the **sole benefit** of the beneficiary (with limited exceptions). If a beneficiary is incapable of traveling alone, the reasonable cost for a companion to travel with the beneficiary is also permitted. But funding the entire family's Disney vacation from the SNT is **not** allowed.
- Distributions from a SNT of any kind **cannot be made directly** to the beneficiary, since doing so likely jeopardizes their eligibility for benefits.

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques:

- Employ staff with subject-matter expertise with regard to the unique requirements of Special Needs Trusts
- Establish and maintain an appropriate process for reviewing all distribution requests from Special Needs Trusts at a Committee or Team level to insure compliance
- Retain advocates and attorneys with relevant experience to assist the Trustee in providing the expertise necessary for proper administration

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions:

It is crucial to be careful when making distributions for the benefit of a SNT beneficiary, especially if the beneficiary receives SSI. Here are ways to make distributions for beneficiaries that will not negatively affect SSI benefits:

- Distribute requested goods or services directly to the beneficiary in person.

Risk #3: Improper Distributions from a Special Needs Trust

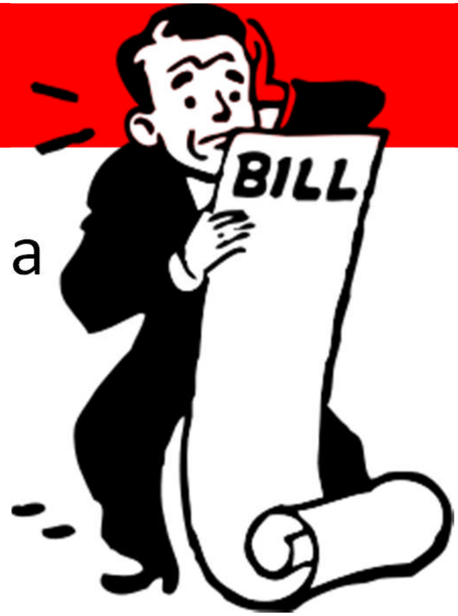
Compliance techniques regarding distributions:

- Purchase goods or services for the beneficiary using Trust funds, and arrange for the goods or services to be delivered directly to the beneficiary. Paying vendors directly is often the best way to manage distributions.
- Reimburse a third party who pays for the goods or services, making sure to obtain proper documentation such as a paid receipt.

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions:

- The Trustee can purchase gift cards or gift certificates for the beneficiary, under limited circumstances. Do *not* provide gift cards that can be used to purchase food or shelter, or those than can be resold. Never provide a debit card, as this is considered cash.



Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions:

- The Trustee can pay a beneficiary's credit card bill directly to the credit card company, under limited circumstances. Special rules apply. A trustee cannot pay for any charges on the card that are for food or shelter, and only those charges for the beneficiary's sole benefit are permitted.
- Use of a "True Link" card has been approved and is an effective tool for managing distributions. For information about "True Link" see https://www.truelinkfinancial.com.

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions for travel:

Strict rules apply for disbursements for travel needs when a beneficiary receives SSI. These rules are under review, and changes may be coming to loosen the rules. For now:

- The Trustee can pay a third party for goods and services for the *trust beneficiary's* travel needs;

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions for travel:

- The Trustee can pay for a third party's travel expenses which are needed in order for the trust beneficiary to obtain medical treatment, or to attend an Individual Education Plan ("IEP") conference for the beneficiary; and

Risk #3: Improper Distributions from a Special Needs Trust

Compliance techniques regarding distributions for travel:

- The Trustee can pay for a third party's travel expenses to visit a trust beneficiary who resides in an institution, nursing home or other long-term care facility (e.g. group homes and assisted living facilities) or other supported living arrangement in which a non-family member or entity is paid to provide or oversee the beneficiary's living arrangement. The travel must be for the purpose of ensuring the safety and/or medical well-being of the beneficiary.

Risk #3: Improper Distributions from a Special Needs Trust

Good -to-Know for all distributions :

- Social Security Administration's "POMS" (Program Operating Manual System) -a guide to what is permitted under Social Security rules. The Special Needs Trustee needs to be familiar with the POMS or employ advocates who have this knowledge.

  - https://secure.ssa.gov/poms.nsf/home!readform
    (public version of the POMS manual)

Risk #4: Lack of sufficient funding to fully pay back the State Medicaid agency after the beneficiary dies

Scenario: The beneficiary of a self-settled SNT dies after having received Medicaid benefits for many years. The State Medicaid agency furnishes a ledger which details every expense paid for the beneficiary, and the total amount due the state exceeds the remaining balance in the SNT.

The State Medicaid agency requires an accounting of the Trust. From inception.

Risk #4: Lack of sufficient funding to fully pay back the State Medicaid agency after the beneficiary dies

Compliance techniques:

- Prepare annual accountings of the SNT and provide notice to the State

- Seek approval from the State prior to making distributions if the Trustee is uncertain and especially if the distribution is a large one

Risk #4: Lack of sufficient funding to fully pay back the State Medicaid agency after the beneficiary dies

Related Complications:

- Following the beneficiary's death, the Trustee cannot make any distributions until the payback is determined. This includes funeral and burial expenses. It is essential that the Trustee engage in **pre-need funeral planning** while the beneficiary is alive, or else risk being without funding to pay for these services when needed.
- It is important to manage the family's expectations following the beneficiary's death, especially if a home is an asset of the Trust.

Tax Compliance

•Self-settled SNT's are **grantor trusts** for income tax purposes.

•Third-party SNT's are **complex trusts** upon the grantor's death**.** In most cases, the third-party SNT can obtain preferential tax treatment if it is a **Qualified Disability Trust** under IRC Sec. 642(b)(2)(C)(ii). This type of trust is entitled to an exemption equal to an individual's personal exemption.

•Be sure to engage an accountant who is skilled in the tax treatment of Special Needs Trusts.

Frances A. Fata
Managing Director-Personal Trust

MB Financial Bank, N.A.
6111 N. River Rd., 8th floor
Rosemont, IL 60018

t: 847.653.2137 Work
f: 847.653.0103
ffata@mbfinancial.com

*Thanks to Illinois attorney Nancy Spain for her insights in discussing this topic and providing valuable research materials.