

USING A SPECIAL NEEDS TRUST FOR CHARITABLE GIVING

I. BACKGROUND

The Special Needs Trust or Supplemental Needs Trust (“SNT”) is a form of discretionary spendthrift trust designed to protect a disabled beneficiary’s government benefits while providing a supplemental fund to provide services and programs not otherwise provided by programs such as Supplemental Security Income (SSI) and Medicaid, Medi-Cal in California.

Individuals with disabilities are eligible for two distinct governmental programs:

1. Social Security Disability Insurance (SSDI) This is an entitlement program for individuals who become disabled and have paid into the social security system. In order to qualify for this program, the individual must prove that he/she has a disabling condition which prevents him/her from obtaining substantial gainful employment. As long as the individual continues to qualify as a disabled individual and does not return to work, money received from inheritances, gifts or unearned income will not affect continued eligibility.

2. Supplemental Security Income (SSI). To become eligible for SSI, an individual must be Elderly (over age 65), Blind or Disabled and have little or no resources or income.¹ SSI provides the necessities of life such as food, clothing and shelter. This program is known as a needs-based program. Currently the federal

¹ 20 CFR §416.202(a) & §416.202(c)-(d)

government pays individuals in this category \$500.00 a month and the State of California provides a supplemental amount which when added together, usually provides a maximum payment per month. **Effective January 1, 2011, the Federal benefit rate is \$674 for an individual and \$1,011 for a couple.** These amounts are indexed annually for inflation and cost of living increases, although the last few years have not seen any cost of living increases.

(a) **Categorically linked Medi-Cal**. For many disabled and elderly, SSI is a crucial link to health insurance. For these individuals who have never been able to obtain employment because of a disability and therefore would not qualify for Medicare, obtaining SSI means that the costs of health care will be provided by the State through the Medi-Cal program. For families with disabled children who are unable to obtain private health care coverage, this program offers the only opportunity for lifetime health care.

(b) **Income Limits**

“Income” is defined in general as payments a person receives either in cash or cash equivalent (in kind income) that can be used to meet the person’s needs for food, clothing, or shelter.² For the year 1998, an individual who is aged, blind or disabled may have earned income annually of \$5,928 and a married couple is entitled to \$8,892.

Example: Amy is an SSI recipient. Her brother pays her rent each month. Amy’s SSI payments will therefore be reduced by one-third. However, if

² 20 C.F.R. § 416.1002

Brian pays Amy's telephone bill, her benefits will not be reduced while payment of electrical or gas bills will also constitute support by a third party.

Unearned Income which is also counted in determining income limits includes:

Annuities

Individual Retirement Accounts

Pensions

Alimony and Support

Dividends

Gifts or Inheritances

Gifts or payments that cannot be used as food, clothing or shelter are not considered income. For example, if Martha's son pays for her prescriptions each month, this is not considered a payment towards food, clothing or shelter and will not affect Martha's SSI benefits.

(c) Resource Limits

In addition to meeting the income limits, SSI applicants must also meet the SSI resource test. For an individual the resource limit is \$2,000 and for a married couple when both are applying for benefits the resource limit is \$3,000.

Resources are cash or other liquid assets or any real or personal property that an individual owns and could convert to cash to be used for support and

maintenance.³ If the individual has the right, authority, or power to liquidate the property, the property is considered to be owned by the individual and is included in the individual's resource calculation.⁴ As further defined by regulation, if a non cash item, such as promissory notes, bonds, mutual funds, joint ownership interests, can be converted into cash within 20 days, then these assets are considered countable resources.⁵

Basically, the individual who is eligible for SSI and Medi-Cal will virtually be someone who is impoverished .

II. PRESERVING GOVERNMENT BENEFITS: *THE SPECIAL NEEDS*

TRUST

A. The Special Needs Trust ("SNT") as part of the Living Revocable Trust or Will.

This author drafts numerous SNTs as part of the estate planning for families with special needs children. In the typical scenario, husband and wife create a Living Trust during their lifetime. Upon the death of the first spouse, a Bypass Trust and a Survivor's Trust are created. At the death of the surviving spouse, the Bypass Trust and Survivor's Trust will be distributed outright to the children. **Exception:** The share that is created for the disabled child will be held in a SNT to supplement government benefits *and with limited exceptions the Trustee will not be permitted to supplement the beneficiary's support and maintenance.* Accordingly, the typical discretionary trust language that

³ 20 C.F.R. § 416.1201.(a)

⁴ 20 C.F.R § 416.1201(a)(1)

⁵ 20 C.F.R § 416.1201(c)

permits the Trustee to distribute income and principal based on an ascertainable standard for health, maintenance, support and education, will cause the beneficiary to lose his/her governmental benefits. According to the Program Operation Manual, (“POMS”), “Trusts as Resources”, which is published by the Social Security Administration,, “.. if an individual can direct the use of the trust principal for her/her support and maintenance under the terms of the trust, the trust principal is a resource for SSI purposes.”⁶

In determining the amount of money that should be set aside for the special needs child and held in a SNT, it is important to note that Social Security looks to the needs of the disabled beneficiary and what is reasonably necessary to meet the individual’s special needs. Therefore, the author, in an attempt to help families provide for a special needs child, often adds sprinkling language to the SNT which permits the Trustee to sprinkle income and principal among the disabled beneficiary and other siblings during the lifetime of the beneficiary. In so doing, one could argue to the Social Security Administration that the SNT funds are not solely for the benefit of the disabled individual and therefore the amount in the trust is not unreasonable or excessive.

Planning Tip: Sample SNT language as part of a Family Living Trust:

⁶ POMS SI 01120.200D.1.b

One advantage of creating the SNT under a Living Trust or Will, is that the provisions can be amended to meet the changing needs of the disabled individual and the changed financial circumstances of parents and/or siblings.

(a) Purpose. This trust is created for the benefit of the Settlor's son, CHARLES SMITH ("CHARLIE"). The primary purpose of this trust is to provide a supplemental and emergency fund to supplement any public benefits available to CHARLIE during his lifetime. The intention of the Settlor is that the assets of the trust shall, to the fullest extent permitted by law, be free from assignment or collection for the satisfaction of the claims of any creditors or government agencies. If this trust were to be invaded by creditors or subject to any liens or encumbrances, or if the terms of this trust were to be applied so as to cause CHARLIE's eligibility for public benefits to be terminated, it is likely that the trust assets would be depleted before his death, and the purpose of this trust could not then be fulfilled.

(b) Funds to Supplement Other Resources. The intention of the Settlor is that any payments or distributions from this trust to or for the benefit of CHARLIE shall supplement any public benefits or other private resources available to him. The Trustee may, in the exercise of the Trustee's discretion, seek as necessary all available public benefits for CHARLIE's benefit, and shall segregate any public benefits received by the Trustee for that purpose in a separate trust or account and administer the same for the benefit of CHARLIE. All public benefits received by the Trustee for that purpose, together with any other resources available to CHARLIE, shall be taken into account by the Trustee in making payments or distributions to or for the benefit of CHARLIE. The Trustee shall regularly consult with CHARLIE and any persons or entities providing care or assistance to CHARLIE for the purpose of determining CHARLIE's needs and resources. The Trustee shall not exercise the Trustee's discretion to make any payments or distributions for the benefit of CHARLIE if the Trustee determines, in the Trustee's sole discretion, that public benefits, private resources, or a combination of public benefits and private resources are reasonably available to CHARLIE to satisfy those needs.

(c) Restrictions on Use of Funds. No part of the income or principal of the trust shall be used to replace or supplant public benefits of any county or any state, federal, or other governmental agency that has a legal responsibility to serve persons with disabilities or conditions that are the same as or similar to those of CHARLIE. For purposes of determining CHARLIE's eligibility for any public benefits, no part of the principal or undistributed income of the trust estate shall be considered available to him, and he shall have no right to compel the Trustee to release principal or income for him benefit or otherwise to have any access to any of the trust assets. In the event that the Trustee is requested to release principal or income of the trust to or on behalf of CHARLIE to pay for any equipment, medication, services, or other needs that any public benefits would be authorized to provide for were it not for the existence of the trust, or in the event that the Trustee is requested to petition any court or any administrative agency for authorization to release principal or income for any purpose of that kind, the Trustee shall deny the request and take whatever administrative or judicial steps may be necessary to continue the eligibility of CHARLIE for all available public benefits, including obtaining a determination or declaration from a court of competent jurisdiction that the trust principal is not available to CHARLIE for purposes of determining him eligibility for any public benefits. Any expenses of the Trustees in this regard, including reasonable attorneys' fees, shall be a proper charge to the trust estate.

(1) Sheltering Trust Assets from Regional Centers. The Regional Centers were established under the Lanterman Developmental Disabilities Services Act. This Trust shall not be liable for the cost of services, aid, insurance, or medical assistance to the beneficiary, as a consumer of Regional Center services, as these terms are used in §4659(a) of the California Welfare and Institutions Code, a successor statute, or other similar statute, or any regulations or other policy promulgated by the Department of Developmental Services, a Regional Center, or any other department, agency, or association. This Trust is intended to supplement other services available to the beneficiary. If those other services are insufficient to meet the beneficiary's needs, the Trustee may exercise his or her discretion in funding the unmet need.

(2) Trust Is the Payor of Last Resort. For purposes of determining the Beneficiary's eligibility for full Regional Center funding, without co-payment, fees, or any contribution whatsoever, this Trust (the corpus and income thereon) shall not be considered a private resource, private entity, generic resource, or a funding

source for services provided without cost pursuant to the Lanterman Act (or a successor statute). For purposes of determining the payor of last resort for Regional Center services, no part of the principal or undistributed income of the Trust estate shall be distributed on demand to pay for services that would otherwise be paid by a Regional Center, pursuant to the Lanterman Act, Title 17 of the California Code of Regulations, or other policies or authorities concerning Regional Center services.

(3) Protection of Trust Assets. The Trustee shall deny any request made by the Beneficiary or by someone on his behalf, or an individual on behalf of the Regional Center, that the Trustee release principal or income of the Trust to or on behalf of the Beneficiary to pay for equipment, medication, or services that the Department of Developmental Services or a Regional Center would or could provide if the Trust did not exist. Moreover, the Trustee shall defend against a request or petition filed in any court or before any administrative agency seeking the release of Trust principal or income to or on behalf of the beneficiary to pay for equipment, medication, or services that the Department of Developmental Services or a regional center would or could provide if the Trust did not exist. The Trustee may, in the Trustee's discretion, take necessary administrative or legal steps to protect the Beneficiary's eligibility for Regional Center funding for any service, support, or goods (medical or otherwise) related to his disability, including obtaining a ruling from an administrative forum or court of competent jurisdiction that the Trust principal is not available to the Beneficiary for purposes of determining any co-payments or other fees for Regional Center services. Expenses for this purpose, including reasonable attorney fees, will be a proper charge to the Trust estate.

Planning tip (d) Payment of In Kind Support and Maintenance. Notwithstanding the foregoing provisions of subparagraph (c), if the Trustee, in the Trustee's sole and absolute discretion, determines after consultation with an attorney who specializes in government benefit law and estate planning for the disabled, that it is in the best interest of CHARLIE to provide in kind support and maintenance (food and/or shelter) to CHARLIE from time to time, then the Trustee may do so as long as CHARLIE's continued right to receive SSI, Medicaid, or IHSS, as the case may be, is not jeopardized and CHARLIE continues to receive all benefits to which he is entitled. Under the current provisions of 20 CFR §416.1130, payment of in kind support and maintenance will only reduce CHARLIE's SSI

Federal Benefit Rate by one-third. As long as this reduction does not disqualify CHARLIE from continued receipt of SSI, even if the SSI amount is reduced to \$1.00, the Trustee may act to make payments of in kind support and maintenance. The Trustee shall be held harmless from all actions taken in making these distributions even if CHARLIE's SSI payments are reduced.

(e) Definition of Public Benefits. As used in this instrument, the term "public benefits" refers to any and all public resources or benefits available under or through any governmental program or agency, including but not limited to any Supplemental Security Income (SSI), Medicaid, or other state medical assistance program authorized under the federal Medicaid program, and federal Social Security Disability Insurance.

(f) Discretionary Payments and Distributions. During the lifetime of CHARLIE, the Trustee shall apply for the benefit of CHARLIE as much of the net income and as much of the principal of the trust as the Trustee, in the Trustee's sole discretion, from time to time deems necessary or advisable for the satisfaction of him special needs. For this purpose, "special needs" refers to the requisites for maintaining the good health, comfort, safety, and welfare of CHARLIE when, in the discretion of the Trustee, those requisites are not being provided for by any public agency, office, or department of any state or the United States, or by any person or persons with a legal obligation to support CHARLIE. "Special needs" shall include, but not be limited to, medical and dental care, special equipment, programs of training, education, and rehabilitation, travel needs, sports classes, and recreation not provided for or reimbursed by public benefits. The Trustee shall consult with any guardian, conservator, custodian, or other person who cares for CHARLIE regarding him special needs. Expenditures made by the Trustee under this section may include reasonable compensation to any person who provides for the special needs of CHARLIE as provided in this section. Any expenditure permitted by this section may be made either with or without prior court order. Any income not paid pursuant to this provision at the end of the calendar year shall be added to the principal of the trust.

(g) Trustee's Power to Make Technical Amendments to Charlie's Trust. Notwithstanding anything to the contrary herein CHARLIE's Trust may be amended from time to time or terminated by a Court of competent jurisdiction in the jurisdiction in which CHARLIE may reside at the time of such proposed amendment, as his circumstances may then require.

(h) Exercise of Trustee's Power. The Settlers contemplate that the Trustee shall exercise its power under Paragraph (g) only if any one or more of the following circumstances has arisen:

(1) Any law applicable to receipt of, or access to, public benefits by CHARLIE is materially changed to such a degree that, without such amendment, the assets of Charlie's Trust cannot be absolutely excluded for all purposes from consideration in determining any public or medical assistance for which CHARLIE would otherwise be eligible.

(2) Any applicable law is adopted that requires that Charlie's Trust be amended in order for the assets of Charlie's Trust to be excluded from consideration as assets, resources or a source of income of CHARLIE under all circumstances.

(3) An amendment of Charlie's Trust would be necessary to permit contributions to be made to Charlie's Trust without causing CHARLIE to be disqualified (for any period) for Medicaid.

(4) An amendment of Charlie's Trust would be necessary to exempt Charlie's Trust from (A) attachment; (B) garnishment; (C) estate recovery; (D) lien; or (E) inclusion as an "available" resource or asset (as that term is used in the context of determining CHARLIE's eligibility for public benefits) of CHARLIE or any third party, by any instrumentality, any creditor of CHARLIE, or any person who may have contributed property to Charlie's Trust.

(i) Limitation on the Trustee's Power to Amend Charlie's Trust. In amplification of Paragraph (g), the Settlers intend that the Trustee shall not exercise its power pursuant to that Paragraph if any such amendment would result in any of the following:

(1) The amendment would cause the income or principal of Charlie's Trust to be deemed available to or "countable" resources or income of CHARLIE, or any person who may have contributed assets to Charlie's Trust.

(2) The amendment would create a period of ineligibility for Medicaid for any person by reason of the transfer of assets to Charlie's Trust.

(j) Trustee's Discretion to Terminate Trust. Notwithstanding any other provision of this instrument, if the existence of the trust or any change in any law, regulation, or rule relating to the trust or the administration of the trust for the benefit of CHARLIE should at any time have the effect of disqualifying him for any public benefits, and amending the trust pursuant to subsections (g-i) will not protect the integrity and purpose of this Trust the Trustee is authorized (but not required) to terminate the trust and to distribute the trust principal and income as provided in this subsection. On any termination of the trust under the provisions of this subsection, the Trustee shall distribute the trust income and principal to JANE DOE.

The Settlers request that any person receiving property pursuant to such a termination conserve, manage, and distribute that property for the benefit of CHARLIE to ensure that he receives sufficient funds for his living needs when public benefits are unavailable or insufficient to satisfy those needs. This request is precatory, however, and not mandatory.

(k) Payment of Death Taxes, Debts and Expenses On Death of CHARLIE. On the death of CHARLIE, the Trustee may pay any death taxes attributable to the property held in trust and the expenses of the last illness and funeral of CHARLIE out of the principal of the trust, unless the Trustee determines that other adequate provisions have been made for payment of these expenses.

(l) Disposition of Trust on Death of CHARLIE. On the death of CHARLIE, the Trustee shall distribute the trust property to the then-living issue of CHARLIE in the manner provided in California Probate Code Section 246, or if CHARLIE has no issue then living, then as follows: 50% to JANE DOE ("JANE") and 50% to PHIL T. RICH ("PHIL"). If either JANE or PHIL fails to survive CHARLIE, then his/her share shall be distributed to his/her issue in the manner provided in California Probate Code Section 246. If an individual issue of Charlie, JANE or PHIL, as the case may be, has not reached the age of twenty-five years (25) on the death of CHARLIE, then the share for that issue shall be held, maintained and distributed by the Trustee in accordance with the terms and provisions of this Article Five, Section 5.3, "Separate Share Trust for Issue".

(m) Final Disposition. If the trust property is not completely disposed of by the preceding provisions, the undisposed-of portion shall be distributed outright to the heirs of the Settlers

B. The Irrevocable Inter Vivos Special Needs Trust

For families with taxable estates, i.e. those in excess of the \$5,000,000 available gift tax credit, creating an inter vivos irrevocable SNT will allow tax free gifting to reduce the overall taxable estate, while at the same time creating immediate supplemental benefits for the disabled person. Through the use of Crummey Powers, a husband and wife can gift \$26,000 to each withdrawal beneficiary, usually siblings of the disabled individual, ***but in no case shall the person with a disability be given withdrawal powers.*** As in Irrevocable Life Insurance Trusts, the withdrawal beneficiaries should be given hanging powers or a testamentary power of appointment over any lapsed gifts. The standard Crummey letter should also be sent to each withdrawal beneficiary.

Planning Tip: Grantor Trust Rules: Consideration should be given to drafting the Inter Vivos Special Needs Trust with Grantor Trust provisions. This author uses those provisions extensively.

The SSI eligibility rules permit a beneficiary to be the recipient of a SNT as long as the trust is irrevocable, the beneficiary has no authority to direct the Trustee as to distribution of income or principal from the trust, and the disabled beneficiary is not the sole beneficiary. To insure that larger corpus trusts are not deemed available to the beneficiary, the use of sprinkling provisions among other classes of beneficiaries is a safe harbor and a good planning device.

Planning Tip: Trust protector: Because the Gift Trust must be Irrevocable under California Law, a Trust Protector should be in place to make changes in Trustees, add additional beneficiaries and reallocate distributions as life changes for the various beneficiaries.

AND the Trust Protector can “turn off” the Grantor Trust provisions if it is later determined that the Grantor no longer wants to impute the Trust income to herself!!

To ensure flexibility and consistency, families should be encouraged to prepare a letter of instruction to the Trustee outlining the standard of care and lifestyle they desire for the disabled family member.

Using an Irrevocable SNT provides gift and estate tax planning for family wealth, while at the same time providing much needed services and benefits to a disabled family member.⁷

⁷ From an article written by Barbara Bergstein, Esq. which appeared in *Tax Information Perspectives, a Publication of the Estate & Gift Tax Subcommittee of the California Tax Bar.*(1997)

C. CHARITABLE GIFTING USING A SPECIAL NEEDS TRUST:

THE CHARITABLE REMAINDER UNITRUST

The Internal Revenue Service (IRS) has ruled that a charitable remainder unitrust may pay the unitrust amounts to a second trust for the life of an individual who is “financially disabled” as defined in Section 6511(g)(2)(a) of the IRS code.

C. The Letter of Intent

As part of creating a SNT for a disabled child, this author advises parents to create a letter of intent advising the Trustee of the life style which should be provided for the disabled beneficiary. It is the greatest fear of parents with disabled children that upon their death, there will be no one to sufficiently manage the care of a disabled son or daughter. Through the letter of intent, parents can plan for the care and comfort of a child above and beyond the necessities of life. This may include having the Trust purchase a home or condominium for the special needs beneficiary, planning vacations, paying for treatments and therapies not otherwise covered by governmental programs and making sure that there are case managers that regularly supervise the disabled individual's living situation.

The letter of intent helps parents plan for the future of their child knowing that the Trustee will have a road map to guide him/her in making the SNT work effectively, and insuring that the child's special needs are met.

V. Conclusion

In administering the Special Needs Trust, the Trustee must be mindful to protect government benefits, understand the income and resource rules of Social Security including the regulations pertaining to in-kind income which could severely impact eligibility. In addition, the Trustee must remember that the SNT is an irrevocable trust that requires fiduciary accountings and income tax returns. Most importantly, the Trustee must remember that the beneficiary of a SNT is an individual who often cannot advocate for himself/herself and will depend upon the Trustee and/or members of the Trust Advisory Committee to undertake the role of advocate as well financial advisor. The duties of the Trustee administering a SNT go beyond the typical trust administration of the ordinary discretionary spendthrift trust. The individual serving as Trustee of a SNT must keep abreast of changes in government benefit law and remain knowledgeable of the resources and programs available to individuals with special needs.

The role of Trustee of a SNT is one of great responsibility, but serving in such a role also brings the satisfaction and reward of knowing that you are helping to enrich a “special” person’s quality of life

