Update on Special Needs Planning 2015

PREGENZER
BAYSINGER
& WIDEMAN
SALE, PC

2424 Louisiana Blvd NE, Suite 200
Albuquerque, NM 87110
(505) 872-0505 (ph)
(505) 872-1009 (f)
www.pbwslaw.com

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I. INTRODUCTION

The cost of care for many disabled persons can be prohibitive and is simply out of reach for most people to afford privately. Because many government-funded programs in the United States today provide substantial benefits, and in many cases are the only available programs for disabled persons, access to these services is critical. However, the requirements for qualifying for these benefits often thwart the efforts of families to provide support to their disabled loved ones. Special Needs Trusts, also called Supplemental Needs Trusts, are the building blocks for accessibility. These trusts are designed to provide assets for the care and comfort of disabled beneficiaries without jeopardizing their access to programs, funds and/or medical benefits that may be available to them. Additional programs have been adopted recently to enhance the lives of people with disabilities, but access to some of these programs is still limited.

To qualify for government benefits for disabled individuals, a person must meet the definition of "disabled." A disabled person, according to the Social Security Administration, is a person who is over the age of 65, blind or unable to do any substantial gainful activity due to severe physical or mental impairments that will result in death or which have lasted for more than one year or will continue for not less than one year. 42 U.S.C. § 423(d) (l) (A). "Substantial gainful activity" is the ability to do work that produces earnings. "Physical or mental impairments" are disabilities that appear on the Social Security Administration Listing of Impairments. If drug addiction or alcoholism are contributing factors to the disability, and if the individual does not accept treatment for addiction, eligibility can be suspended. Social Security publishes the Program Operations Manual System to help caseworkers determine disability.[1]

[1] The "POMS" are the regulations described under the Program Operations Manual System, which are written to instruct Social Security caseworkers in the various offices throughout the United States. One can access the POMS pertaining to Supplemental Security Income at https://secure.ssa.gov/poms.nsf/Home?readform. The POMS that are pertinent to the subject of this paper are found in the SI-Supplemental Security Income section. While the POMS do not carry the weight of regulations in the Tenth Federal Circuit (See *Ramey v. Reinertson*, 268 F.3d 955 (10th Circuit 2001)), they are very helpful and the most detailed policy guidelines that exist in the area of special needs trusts.

Once a disability is established, the type of benefit available will depend on additional criteria. Some programs, such as Social Security Disability Income ("SSDI"), base the benefit on the earnings of the worker prior to her disability. With this benefit comes Medicare, which is a medical insurance program available to all workers who are disabled or to most people who have attained age 65. Receipt of SSDI and Medicare depends exclusively on disability or age and prior work history. There is no limit to unearned income or assets that can be owned by an SSDI or Medicare recipient. In contrast, programs such as Supplemental Security Income ("SSI") and Medicaid are "means-based" programs, which measure the current income and resources of the disabled person to establish eligibility. In order to access these benefits, the recipient must not only be aged, sick and/or unable to work, but very, very poor. If additional assets become available to an SSI or Medicaid recipient, the benefits will be curtailed until those assets are used up. When the excess assets are gone, the disabled person can reapply for the benefits.

Government benefits for people with disabilities include cash payments and health care. SSI and SSDI provide cash for disabled individuals. For many recipients, this is the only monthly cash that they receive. The primary government health care programs are Medicare and Medicaid.

Medicare provides coverage for acute care, such as hospitalization and some limited rehabilitation. Under the Medicare law passed in 2003, prescriptions were covered beginning in 2006.[2] The Patient Protection and Affordable Care Act of 2010 ("ACA") increased the benefit of this prescription drug coverage by closing the gap for prescription drug costs, called the doughnut hole.[3] Medicare recipients may also have access to private health insurance, which often pays for prescriptions and doctor visits. Medicare is administered directly by the federal government.

[2] Medicare Prescription Drug, Improvement, and Modernization Act of 2003, www.medicare.gov. Medicare and Medicaid are administered by the Centers for Medicare and Medicaid Services ("CMS") under the United States Department of Health and Human Services.
[3] 42 U.S.C. § 1395w-114A.

Medicare does not exclude anyone with a pre-existing condition. However, Medicare does not cover the cost of long term custodial care. Long term care insurance will pay for custodial care, but is not available for someone who is already disabled.

Medicaid is the only government program in the United States that provides for long term skilled nursing care for disabled persons other than Veterans Affairs. Medicaid pays for prescriptions, therapy, and doctor visits as well as custodial care. Medicaid, while a federal program, is administered by the states. Therefore, a Medicaid recipient who moves from one state to another state will have to reapply for Medicaid services in the new state of domicile. Regulations differ from one state to the next. In New Mexico, Medicaid, which is now called Centennial Care, provides funding for various programs, which include HMO services through Molina, Blue Cross and Blue Shield, Presbyterian and United Health Care, institutional care in nursing homes and other facilities, financial assistance for the payment of Medicare premiums, Total Community Care, which provides home-based services for the elderly (available only in Bernalillo, Valencia and Sandoval counties), and the Developmentally Disabled ("DD Waiver"). In 2015, Mi Via and Medically Fragile programs, which provide community based services for disabled individuals of all ages, are provided by Centennial Care providers.[4] In order to qualify for these benefits, a recipient must be disabled and must be essentially indigent. There is a limitation on the amount of income that a Medicaid recipient can receive each month ($2,199.00 plus $20.00 in 2015), and the total amount of countable resources that a Medicaid recipient can have in any one month is $2,000.

Implementation of the Affordable Care Act may have reduced the need for some of these government programs for some beneficiaries. For example, because health insurance companies will no longer be able to deny coverage on the basis of a pre-existing condition, many people with disabilities whose needs are primarily medical, such as medications and therapy maintenance, may no longer need Medicaid for those services.

[4] Information about these services can be found at http://www.state.nm.us/hsd/mad.

As a result of the ACA in New Mexico, Centennial Care, beginning in 2014, was offered to individuals and families whose income was less than 138% of the Federal Poverty Level ("FPL"). The only thresholds for eligibility for this coverage are age, 19 through 64, and income. The applicant does not have to be disabled and can own unlimited resources, which are not counted. This is called Medicaid Expansion under the ACA.

The dilemma for families with disabled family members has always been how to provide a decent and meaningful lifestyle for their loved one while at the same time guaranteeing access to crucial government benefits. Historically, families have tried various methods to protect the benefits for a disabled family member when additional assets may have been available that would cause disqualification. They might intentionally disinherit the loved one. They might attempt to create oral trusts or other arrangements with surviving family members. These methods have often had heart breaking and cruel results or can be ineffective or fraudulent. On the other hand, many relatives cannot bring themselves to disinherit a disabled beneficiary. As a result, the disabled beneficiary receives a gift or a share of an estate outright, and thus loses her government benefits until the gift or inheritance is used up. Planning with Special Needs Trusts can solve this dilemma.

An exasperating though common occurrence is a disabled child of a deceased or retired parent receiving automatically a lump sum payment from Social Security that is the accumulated SSDI benefit of the parent. The child is entitled to this benefit, which is a continuation of the parent's Social Security benefit. However, because Social Security may have taken two years to compute the benefit of the parent, it arrives as a lump sum that is far more than $2,000. The receipt of this payment, though received because the child is disabled, will cause ineligibility until the excess resource is used up. Planning with Special Needs Trusts can solve this dilemma.

Some disabilities are the result of someone else's negligence. In these cases, the disabled person may recover damages. However, the injured person may require lifetime assistance at enormous cost, which may be well beyond the amount of the recovery. Treatment of the effects of the injury necessitates government-provided benefits. Therefore, even though a recovery may

provide substantial assets, the recovery itself can put access to these benefits at risk.[5] Planning with Special Needs Trusts can solve this dilemma.

Finally, one can never predict whether or not a future beneficiary may become disabled. Estate planners can build language into their documents that provides for contingent Special Needs Trusts in the same manner that most documents now provide for contingencies such as minority trusts.

The reality for people with disabilities in the United States is that to access crucial and necessary services, the disabled person must be impoverished, and must remain impoverished, in order to maintain eligibility for those services.

II. HOW THE GOVERNMENT BENEFITS SYSTEMS WORK

A. The Basics

Planning for disabled beneficiaries requires a basic understanding of how government benefits systems work. These programs disburse benefits to millions of people in the United States every month. Yet, most people, particularly professionals, do not have a grasp of the features and the distinctions among them. The names of the programs are very similar, which makes it more confusing. While access to the means-based programs requires special planning, it is important to know how other programs interrelate and in some cases complement the means- based programs. To help in that understanding, we have prepared two simple charts to illustrate and compare three programs provided through Social Security and to compare Medicare and Medicaid.

[5] For more information about how to protect public benefits for disabled plaintiffs who recover damages throughout the United States, contact the Special Needs Alliance, www.specialneedsalliance.org

Comparison of Three Social Security Programs

SSI	SSA	SSDI
Supplemental Security Income	Social Security	Social Security Disability Income
Disability	Retirement	Disability
Cash + Medicaid	Cash	Cash + Medicare (After 2 years)
No work history	Work history	Work history
Income Cap - $733/month in 2015	Income Cap - $15,720/yr in 2015, if under age 66	Income Cap - $1,090/month in 2015
Earned & unearned income	Earned income	Earned income
Resource cap - $2000.00	No resource cap	No resource cap
Minimum cash benefit	Insurance	Insurance
Food and shelter	Unrestricted	Unrestricted
State supplements (Not NM)	Uniform in all states	Uniform in all states
US citizens only	All workers	All workers
May also have SSDI	May not have SSI or SSDI	May also have SSI
No dependent coverage	Covers dependents	Covers dependents

Comparison of Medicaid and Medicare

	Medicaid	Medicare
Program:	Health Care	Health Insurance
Administered by:	States	Federal
Eligibility:	Must Qualify	Entitlement
Qualifications:	Financial **&** Disability	Age **or** Disability
Covers:	Several in-home care programs; Skilled nursing care; Long Term care; Prescriptions	Hospitalization; 100 days maximum rehabilitation; Prescriptions
Contribution:	Reimbursement required	Premiums and co-pay
Estate Recovery:	Yes	No

B. Means-Based Programs

In 1965, President Johnson signed the bills that created a health insurance program for retired Americans, Medicare, and a health care program for needy families, Medicaid. The bill was an amendment to the Social Security Act. It had originally been proposed by Harry Truman in 1945. In 1972, President Nixon signed the Social Security Amendments of 1972 which created the Supplemental Security Income ("SSI") system. Although the benefits under Medicaid and SSI are different, the rationales for the two systems are quite similar, and both find their statutory basis in the Social Security Act. SSI provides minimal cash payments each month that are designated to provide for food and shelter. In order to maintain eligibility for SSI, a recipient cannot receive income from any source in excess of $733.00 per month in 2015. Income, according to the SSI rules, is anything that "comes in" to the recipient in any month. At the end of the month, income that is not used up converts to a "resource." Thus, a resource can be accumulated income. An SSI recipient is not allowed to own resources that are available to be spent on food and shelter in excess of $2000.00. Income and resources are measured independently. The analysis for Medicaid eligibility is quite similar, although the income threshold is higher. In New Mexico, for most Medicaid programs, the income threshold in 2015 is $2,199.00 plus $20.00 per month.

Some income and some resources are exempt from the eligibility calculations. Non-countable income includes other means-based payments such as food stamps, medical care and services, income tax refunds, loans, and any item that if retained would not be a countable resource. Exempt resources include the personal residence of the recipient; one vehicle, if it is needed to provide transportation to work, to medical services or is specially outfitted for the disability; household contents, such as computers, electronics, physical training equipment, hot tubs and ordinary furnishings for living; life insurance with a face value of less than $1,500.00 and irrevocable burial plans. Thus a disabled adult who owns a $400,000 house,[6] a $60,000

[6] The Deficit Reduction Act of 2005, signed by President Bush on February 8, 2006, requires that Medicaid eligibility shall be denied to applicants who have more than $500,000 in equity in their home. New Mexico has increased this figure to $828,000 in 2015.

specially outfitted van, whose life is insured by a $2 million term life insurance policy, and who has limited income, could qualify for SSI.

Income and resources of family members can be deemed to a disabled family member under the SSI rules. This deeming concept is an odd one, but the rationale is that since SSI benefits are to provide food and shelter, if an SSI recipient is receiving some of those items from another source, then the ability of that source to provide those items is "deemed" to the SSI recipient, as if the SSI recipient were able to provide these services by herself. For example, in order to maintain SSI eligibility for a disabled child, a family which is supporting three children, one of whom is disabled, will be limited in the total amount of income that the family may earn each month if it wants to protect the disabled child's benefits. A portion of the family's income will be deemed to belong to the SSI recipient. If the family earns too much income, the disabled minor child will not be eligible for SSI. There is a similar analysis for deeming resources.

But why is this significant? The government-provided cash benefit under SSI is paltry, a maximum of $733.00 per month in 2015. The amount of the SSI benefit is so small that maintaining SSI eligibility hardly seems to be a worthy goal. The prize that makes the quest worth pursuing is Medicaid. In many states, including New Mexico, eligibility for SSI categorically results in Medicaid eligibility. For many disabled individuals, such as disabled children, disabled adults who have no work history, and disabled adults whose work history does not provide an SSDI benefit at all, or one that is below $733.00 per month, SSI provides the gateway to the substantial medical benefits of Medicaid. As the charts demonstrate, no other government benefit besides Medicaid provides comprehensive, long term custodial and medical care. Therefore, observing the qualification criteria for SSI will enable a disabled beneficiary to receive medical care that she may not be able to obtain from any other source. If an individual is unable to qualify economically for SSI, she may be able to apply directly for Medicaid. The eligibility requirements for Medicaid are also means-based, requiring that the individual have minimal countable income and resources, but there are not the same deeming rules as there are with SSI.

C. Additional Related Programs

The ACA provides that health insurance coverage cannot be denied to anyone with a pre-existing condition, beginning in 2014. Access to basic health insurance may allow some Special Needs Trust beneficiaries to opt out of the Medicaid system. Additionally, the ACA has expanded Medicaid health coverage to low income adults in New Mexico.

In December, 2014, Congress passed the Stephen Beck, Jr., Achieving a Better Life Experience Act ("ABLE") in December, 2014. The federal law amends Section 529 of the Internal Revenue Code as a new Section 529A. Only people whose disability was established prior to age 26 can open an ABLE account. Anyone can contribute to an ABLE account, but the total of all contributions in any one year cannot exceed $14,000, the annual gift tax exclusion amount. The funds in the account can grow income tax deferred, similar to an IRA or 529 plan. Distributions for the benefit of the disable beneficiary can be made, income tax free, for education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight, monitoring, funeral and burial expenses, and other expenses approved by the US Secretary of the Treasury. Up to $100,000 in the ABLE account is excludable for SSI purposes. The beneficiary may direct the investments of the ABLE account, limited to twice a year. State must elect to participate in the ABLE program. The ABLE account must be opened in the state where the beneficiary resides. There is a limit of one ABLE account per beneficiary. Medicaid, which is described as a creditor in the statute, gets paid back at the death of the beneficiary for any amounts paid by the state for the care of the beneficiary after the establishment of the account. Enabling legislation was introduced in the 2015 session of the New Mexico Legislature, H.B. 448, but was not considered. Twenty-five other states have passed enabling legislation as of July, 2015.

In December 19, 2014, President Obama signed the Disabled Military Child Protection Act, which is Section 642 of the National Defense Authorization Act of 2015. This Act allows the disabled children of retired military personnel to have survivor benefits under military pensions be

directed to a Special Needs Trust for the child. As of June, 2015, it was learned that guidelines were in the process of being written, but are not yet available. For more information, see "The Voice," published by the Special Needs Alliance (www.specialneedsalliance.org).

III. REQUIREMENTS OF SPECIAL NEEDS TRUSTS

A properly drafted Special Needs Trust preserves and shelters assets for the benefit of a disabled person so that she can obtain means-based benefits and have additional comforts, enjoyment, education, entertainment and medical care not otherwise provided by the government programs. In order for a Special Needs Trust to qualify as a non-countable resource, it must be written and its terms express. All distributions of income and/or principal must be in the discretion of the trustee. The beneficiary cannot be given the power to demand income or principal. The Trustee must be prohibited from making any distribution that would jeopardize the recipient's benefits. The Special Needs Trust can delineate those items or categories for which distributions are proper. The language should never require distributions for health, support, food or shelter. The disabled individual must be the sole beneficiary of the trust during her lifetime. A Special Needs Trust must be irrevocable.

A. Third Party-Settled Trusts

The least problematic Special Needs Trust is the third party-settled trust.[7] This can be either an inter vivos irrevocable trust or a testamentary trust. If the Special Needs Trust is a testamentary trust, it is settled law that it will not be counted as a resource for a disabled beneficiary.[8] For a person other than the disabled individual to fund an irrevocable Special Needs Trust for that disabled beneficiary during the lifetime of the grantor, even though it is not a countable resource, it is advisable to have the trust agreement reviewed by the case administrator in the Social Security office before funding, so that one is not accused of failing to disclose information. A third party-settled Special Needs Trust can provide for a testamentary special

[7] The POMS exclude third party trusts from special scrutiny. POMS SI 01120.200 D2.

[8] Transmittal 64, issued by Sally Richardson of the Health Care Financing Administration (now CMS) in November, 1994, states that for the purposes of Medicaid, the definition of "trust" does not include a trust established by Will. Section 3259.1.A.1. Transmittal 64.

power of appointment for the beneficiary, or can provide that the trust be distributed to the chosen remainder beneficiaries of the grantor at the death of the beneficiary. The corpus of a third party-settled Special Needs Trust can be preserved for future beneficiaries. In New Mexico, there is no need for independent review of a third party-settled Special Needs Trust by Medicaid, although Medicaid may request such a review.

B. Self-Settled Trusts

In 1993, Congress provided in 42 U.S.C. § 1396p(d)(3) that a person could not attain Medicaid eligibility by transferring her own assets to an inter vivos trust, even if the trust was irrevocable and the Medicaid applicant had no further control over the assets, **unless** the transfer took place more than 5 years before the Medicaid application.[9] A transfer to the trustee within the 5 year period results in the assets being attributed to the applicant for the period of time that it takes to use up those assets to pay for the care of the applicant. This "penalty period" can put the applicant in the worst possible situation, i.e., not having the assets to pay for care, but being penalized as if the applicant has the assets, and therefore being unable to obtain Medicaid.[10] Transferring one's own assets to a trust as a planning method 5 years in advance of need is only feasible when the disability can be planned for, such as with a Parkinson's patient or an Alzheimer's patient.

For victims of accidents or disabling conditions from birth or with an unpredictable onset, this is not an option. For example, under SSI rules, a plaintiff in a personal injury suit is deemed to have constructive ownership of any recovery, even if the court establishes a Special Needs Trust. Because these assets are attributed to the plaintiff, if the plaintiff is disabled, the recovery would prevent eligibility for much needed means-based benefits. However, under 42 U.S.C. § 1396p (d)(4), two types of safe harbor trusts are described that can relieve this dilemma for SSI and Medicaid eligibility. Transfers of the disabled person's assets to these safe-harbor statutory self-settled trusts are exempt from the transfer penalty.

[9] The Deficit Reduction Act of 2005 extended this five year look back period for trusts to all transfers of any sort.
[10] The Deficit Reduction Act of 2005 mandates that the date of any transfer within the past five years will be deemed to be the date of the application for Medicaid, which means that the penalty period for a transfer begins on the date of application, not on the date of the transfer.

1. "(d)(4)(A) Trusts"

The first type of trust is provided for in 42 U.S.C. § 1396p(d)(4)(A) and is commonly called a "d4A" trust. Because the d4A trust is funded with the beneficiary's own assets, the statute requires that at the death of the beneficiary, the remaining assets in the trust must be used initially to reimburse any state government that provided Medicaid to the beneficiary. Therefore, this trust is often called a "payback trust."[11] In addition to the payback requirement, the d4A trust must be irrevocable; it can be created **only** by a parent, grandparent, court or guardian; and the disabled beneficiary must be younger than 65. Funds of the beneficiary transferred to the trust after age 65 will not be exempt transfers. Anyone other than the disabled person can be the trustee of the trust. The trust can provide that after the beneficiary's death, once Medicaid is reimbursed, the remaining balance of the trust fund can be distributed to the intended beneficiaries of the disabled person.

The beneficiary cannot be the grantor, even though the assets being transferred to the trust are attributed to the beneficiary. This limitation on permissible grantors can be cumbersome. However, H.R. 670, the Special Needs Trust Fairness Act of 2015 was introduced on February 3, 2015, in the House of Representatives. One of its provisions is to add the beneficiary as a qualified grantor of a (d)(4)(A) Special Needs Trust. This bill was approved by the Senate Finance Committee on July 30, 2015. If a disabled beneficiary is incompetent, it is a simple matter to have a conservator appointed to create the trust. However, a disabled adult who has no living parent or grandparent and who is competent has more difficulty complying with the statute.[12] If

[11] 42 USC 1396p(d)(4)(A) states: **(4)** This subsection shall not apply to any of the following trusts: **(A)** A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1382c (a)(3) of this title) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if 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 under this subchapter.

[12] POMS SI 01120.203.B.1.e specifies that "the person establishing the trust must have legal authority to act with regard to the assets of the individual." It is considered an invalid trust if the parents of a competent adult child create the trust as settlors, and then pursuant to a power of attorney deposit the assets of the child into the trust. Currently there are two solutions to this dilemma. The first is to petition the court for a limited conservatorship specifically for the purpose of transferring the assets of the disabled adult child into the trust. The second is a device created by the Social Security Administration called the "seed trust" or the "$10.00 trust." With this device, the parents deposit $10.00 of their own funds into the trust, thus "establishing" the trust, and then transfer the child's funds into the trust using a power of attorney. .

the funds are not the result of a settlement by which a court could create the trust, and there are no parents or grandparents, the disabled person must submit to a limited conservatorship to fund the trust in order to comply with the statute.

The trust document will be reviewed by the Social Security Administration and, because of the payback provision, by Medicaid. The standard of review should be the same. However, for the past several years in New Mexico, the General Counsel's office that represents Medicaid has initiated a separate review for each self-settled trust and has been aggressive in its approach. For the past few years New Mexico Medicaid has determined unofficially that self-settled trusts in New Mexico should conform to a certain form. That form was one that was attached as a sample form to materials prepared by Attorney Susan Tomita for a seminar on Medicaid given in 2003. New Mexico Medicaid has long attempted to restrict the effectiveness of self-settled Special Needs Trusts. New regulations were proposed in December, 2011, with a proposed effective date of February 1, 2012. Written and oral comments were made by many lawyers, trustees and advocates opposing most of the proposed regulations. It was suggested to the Human Services Department that before implementing the proposed regulations, a task force should be formed that would include the entire disability community, but this was rejected. The new regulations went into effect on October 1, 2012.[13] Some of these regulations may be unconstitutional, because several provisions require more restrictive Medicaid eligibility criteria for beneficiaries of Special Needs Trusts than federal law requires (See Lewis v Alexander, 2011 WL 3678721 at 15-16), narrowing the definition of "sole benefit" so as to harm beneficiaries, proclaiming that the Human Services Department of New Mexico is a remainder beneficiary of Special Needs Trusts rather than a creditor as described in federal law, limiting distributions for

[13] See the regulations at http://www.hsd.state.nm.us/mad/pdf_files/eligmanl/8%20281%20510%20ss.pdf

shelter, even though Medicaid is a health benefit and has nothing to do with shelter, and prohibiting the direct conversion of Special Needs Trusts to pooled trust accounts (described in the next section). When preparing a self-settled Special Needs Trust for a beneficiary or her family, or when representing a trustee, one must counsel the clients carefully that while Social Security may approve the trust, there is still a Medicaid hurdle in New Mexico.

2. "(d)(4)(C) Trusts"

The second type of safe harbor for a self-settled trust is found in 42 U.S.C.§1396p(d)(4)(C).[14] In this case, if the disabled person transfers her own funds to a non-profit 501(c)(3) organization as trustee, which manages the funds as part of a pooled trust for disabled persons, the transfer is exempt from penalty. The federal statute provides that the trust must be irrevocable; it can be created by the beneficiary as well as by a parent, grandparent, court or guardian; and the statute does not specify a maximum age of the beneficiary. The New Mexico regulations state that people over age 65 who fund a (d)(4)(C) trust may be subject to a transfer penalty, even though that is not in the federal law. 8.281.510.11 D(1)(d)(iii). Furthermore, New Mexico regulations specify that the non-profit trustee must notify the department in writing in advance of any transactions involving transfers from the trust principal for less than fair market value. 8.281.510.11 D(2)(c). At the death of the beneficiary, the regulations state that "to the extent that any amounts remaining in the applicant/recipient's trust account upon his/her death are not retained by the trust, the trust pays to the department an amount equal to the total amount of Medicaid benefits paid on behalf of the applicant/recipient." 8.281.510.11 D(1)(d). This regulation

[14] 42 USC 1396p(d)(4)(C) states: **(C)** A trust containing the assets of an individual who is disabled (as defined in section 1382c (a)(3) of this title) that meets the following conditions: **(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.

exceeds what is stated in federal law. (See *First Capital Surety v. Delaware*, 2012 WL 4471244). There are currently four pooled trusts in New Mexico. The ARCA Foundation is the trustee of a pooled trust for the clients of ARCA and other people with developmental disabilities; in Santa Fe, the Knights Templar Foundation is a trustee of a pooled trust to benefit the clients of Easter Seals Santa Maria el Mirador; CARC, Inc. serves as trustee of a pooled trust to benefit its clients in Carlsbad; and The ARC of New Mexico serves as trustee of a pooled trust that can benefit any disabled person who applies to open an account with them, in New Mexico or elsewhere. These pooled trusts have been approved in advance by New Mexico Medicaid.

IV. TRUSTEES OF SPECIAL NEEDS TRUSTS

Trustees of Special Needs Trusts have the same duties as trustees of other trusts, which are to abide by the terms of the trust agreement in the best interest of the beneficiaries, to not waste or squander the trust assets, to be loyal to the beneficiary above all others, and to exercise the level of care of a prudent person. However, trustees of a Special Needs Trust have added responsibilities because of the disability of the beneficiary and the special conditions that apply to distributions from the trust.

A trustee of a Special Needs Trust must develop a working knowledge of the government benefits for which the beneficiary is qualified, because the trustee must understand which distributions are appropriate and which are not. This can mean **not making** certain distributions, such as cash to an SSI beneficiary, as well as **making** other distributions. A Special Needs Trust trustee must know the long term care plan for the beneficiary, her life expectancy, and what activities are possible or are reasonable to expect. A trustee of a Special Needs Trust should be creative in anticipating activities or items that will enhance the beneficiary's life. For example, a beneficiary who is totally physically disabled, and who requires 24 hour care in a nursing home,

but who is not totally mentally disabled, might enjoy a trip to the zoo or to a play.

A Special Needs Trust trustee must understand which distributions would jeopardize the benefits being received. For example, SSI beneficiaries receive cash payments from the Social Security Administration that are deemed to be for the recipients' food and shelter. The receipt of any additional cash, or any item that would be "in-kind support and maintenance," will reduce the monthly SSI benefit, up to a one-third reduction. Therefore, the trustee should not pay the rent for the beneficiary who received SSI without realizing that such a payment may reduce the monthly cash benefit, because that is an in-kind payment for shelter. This is not to say, however, that it might not be prudent for the trustee to pay the rent, even though such payment will result in the reduction of the monthly benefit by one third, because the overall enhancement for the beneficiary might outweigh the reduction in cash.

Although this is not strictly the responsibility of the Trustee, the SSI program requires periodic reporting for all SSI recipients. Eligibility will be denied if the reports are not complete. The existence of the Special Needs Trust must be reported to the Social Security Administration and to Medicaid. Additionally, if the beneficiary changes her address, gets married, obtains more resources or more income, or is no longer disabled, these changes must be reported by the beneficiary to Social Security. The report is due within 10 days of the end of the month in which the change occurs.

The beneficiary or her agent must respond promptly to any notices received from the Social Security Administration or from Medicaid. If notice is given of a change in benefits that is detrimental to the beneficiary, the beneficiary has 60 days in which to file a written notice of an appeal with Social Security in order to keep the benefits in place during the appeal process. The beneficiary cannot ignore or postpone dealing with the government agency.

Trustees of Special Needs Trusts should also know about other programs or services that might be available to the beneficiary for which the trust could provide or pay for. For example, a trustee should analyze whether purchasing health insurance is feasible or worth doing now that a person with a disability or a pre-existing condition cannot be denied health insurance; or whether to create an ABLE account with a small amount of funds; or whether the beneficiary could qualify for Medicaid expansion under the ACA, which does not have a resource restriction. The trustee should continuously balance the well-being of the beneficiary with the extreme restrictions that come with government benefits, as well as the Medicaid payback at the end of the beneficiary's life.

As with many types of trusts, there is good reason to consider having co-trustees of Special Needs Trusts. If the trust holds significant assets, a corporate trustee may be beneficial for long term investment expertise. However, an appropriate family member could be a co-trustee in order for the day-to-day needs of the beneficiary to be monitored. Trustees of Special Needs Trusts often need ongoing legal representation. To the extent possible, the trustee should stay abreast of changes in the law. We recommend an annual review meeting with the trustee and legal counsel.

V. TAX ISSUES

A. Federal Gift Tax

Generally, gifts of any amount to third party-settled Special Needs Trusts with one beneficiary are taxable gifts. The $14,000 annual exclusion from gift tax rule does not apply to these transfers, because the use of the gift for the beneficiary is postponed into the future. In trusts other than Special Needs Trusts, this problem is often addressed by the use of "Crummey powers." A notice is sent to a beneficiary by the trustee giving her a right that exists for a limited

time to withdraw the gift. The Crummey power converts the gift from a gift of a future interest to a gift of a present interest, thus making it eligible for the annual exclusion. But, because the beneficiary of a Special Needs Trust cannot be given the authority to demand withdrawal of any amount from the trust at any time, Crummey powers should not be given to her.

One way to solve this problem is to include other family members of the beneficiary as beneficiaries of the trust, with the limitation that if the disabled family member is receiving means-based government benefits, then the corpus of the trust is first to be used for the special needs of the disabled family member. This creates potential donees of the Crummey powers only for the purpose of transferring non-taxable gifts into the trust.

The third party-settled trust can be structured as a grantor trust, which keeps the transfers into the trust from being completed, and therefore, taxable gifts. The grantor is treated as the owner of the trust for income tax purposes. This can be accomplished in several ways. A simple method is to name the grantor as trustee, so that she will retain the power to direct disposition and enjoyment of the trust. An additional method is to give the grantor a testamentary limited power of appointment over the trust.

Self-settled Special Needs Trusts are grantor trusts, because the beneficiary is deemed to be the grantor even though she may not be the formal grantor of the trust. Therefore, a transfer to a self-settled trust by the beneficiary is not a gift at all.

By statute, annual gifts to ABLE accounts are gifts of a present interest and are not taxable gifts.

B. Federal Estate Tax

A third party-settled Special Needs Trust will not be included in the federal taxable estate of the grantor if the third party donor makes a completed gift to the trust. The third party-settled trust is not includable in the federal estate of the beneficiary, because the beneficiary does not

have sufficient control over the trust fund to warrant inclusion, unless the beneficiary is given a general testamentary power of appointment over the trust. There is no reason why a third party-settled trust should not include generation skipping transfer tax exemption planning, especially if it is believed that there will be a large amount of corpus left over after the death of the beneficiary, which will pass to other family members and grandchildren.

The self-settled Special Needs Trust will be included in the beneficiary's federal taxable estate, because of the beneficiary's retained interest. However, the Medicaid payback provision may significantly reduce the value of the trust fund, if not eradicate it altogether. Furthermore, careful planning by the trustee can result in distributions from the trust being sufficient to reduce the corpus to avoid federal estate tax as well as to reduce the Medicaid payback.

C. Fiduciary Income Tax

A third party-settled Special Needs Trust which is not a grantor trust should be assigned its own taxpayer identification number. It will file an income tax return for each calendar year, which is due on April 15 of the following year. While the trustee is prohibited from distributing cash directly to the beneficiary, fiduciary income tax rules require that the trustee report as distributable net income the value of all distributions from the trust up to the amount of the net taxable income of the trust for that year. For example, if the trustee distributes funds for the purchase of a vehicle, which is titled in the beneficiary's name, this is an acceptable distribution of funds for an exempt resource. It will not disqualify the beneficiary from SSI or Medicaid as a distribution of income. However, to the extent that the trust had earnings, the distributable net income rules require that the trust report those earnings up to the amount distributed for the value of the vehicle as having been distributed to the beneficiary as income on a Schedule K-1. The beneficiary will report the income on her individual income tax returns, even though she did not receive the income in the form of cash. The trustee can pay the cost of preparation of the

income tax returns and can pay any income tax due directly to the taxing jurisdiction.

A Special Needs Trust is a complex trust, meaning that the Trustee has discretion to distribute income or principal. If the trust retains income, the trust will be the taxpayer for that taxable income. A complex trust may take only a $100 exemption against its taxable income. The Internal Revenue Code provides an exception for some Special Needs Trust beneficiaries. 26 USCA section 642(b)(2)(C)(i),(ii). This statute was passed as a part of the Victims of Terrorism Tax Relief Act of January, 2002. It provides for a higher tax exemption if the trust is what is defined as a Qualified Disability Trust ("QDT"), that is, one that is established solely for the benefit of an individual under 65 who is disabled. A trust is a QDT even if a remainder beneficiary is not disabled. For a trust that meets the definition of a QDT, the exemption that is allowed for the trust is the allowable personal exemption for the individual beneficiary. In 2015, the personal exemption is $4,000. Therefore, if a QDT retains $5,000 of earned income, after taking the exemption amount, it will report $1,000 taxable income in 2015, and pay income tax in a 15% bracket in the amount of $150. A complex trust that was not a QDT will have only a $100 exemption, and thus will report $4,900 taxable income and pay $975 in tax going up from a 15% bracket to a 25% bracket.[15]

In 2013, the Affordable Care Act added a 3.8% Medicare surtax on unearned income taxed at the 39.6% bracket. Therefore, non-grantor Special Needs Trusts with taxable income of more than $12,150 in 2014 will also be liable for the surtax. The American Taxpayer Relief

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[15] Income tax rates for estates and trusts in 2014:

If Taxable Income Is:	***The Tax Is:***
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,800	$375 plus 25% of the excess over $2,500
Over $5,800 but not over $8,900	$1,200 plus 28% of the excess over $5,800
Over $8,900 but not over $12,150	$2,068 plus 33% of the excess over $8,900
Over $12,150	$3,140.50 plus 39.6% of the excess over $12,150

Act of 2013 ("ATRA") increased the capital gain tax rate to 20% for trusts with income above $12,150 in 2014.

If a third party-settled trust is a grantor trust, it does not need to have a tax identification number different from the grantor, and the income will be deemed to be distributed and taxable to the grantor. One advantage of a third party settled Special Needs Trust being a grantor trust is that the grantor, who is often a close family member of the disabled beneficiary, can effectively give more to the beneficiary by paying the income taxes on the earnings of the trust.

Self-settled Special Needs Trusts are grantor trusts, and therefore, do not need to be assigned a separate taxpayer identification number, but use the Social Security number of the beneficiary. The income and expenses of the trust are reported on the beneficiary's individual income tax returns. In spite of this reality for income tax purposes, it is not uncommon for a different tax identification number to be assigned to a d(4)(A) trust, because the agencies providing the benefits may not understand that the trust is a separate entity from the beneficiary, and irrevocable, if it uses the Social Security number of the beneficiary.

VI. CONCLUSION

In the United States today, a permanent total disability brings with it economic peril. A person who is born with autism, or who suffers from Alzheimer's, or who has a spinal injury, must address both the critical medical treatment required as well as the loss of economic self-sufficiency. Medical care is extraordinarily expensive and ongoing. Although the ACA and Medicare provide access to health insurance for disabled individuals, many disabilities necessitate special housing, transportation and education, which are not covered by health insurance. While many private charities provide worthwhile services, the enormous cost of caring for long term disabled persons in this country is necessarily borne primarily by the government. However,

maintaining eligibility for government programs often contradicts the efforts of family members to provide support and care for their loved ones. Special Needs Trusts provide a mechanism for sheltering resources to benefit disabled family members so that these contradictory efforts can be harmonized. A well-managed support system using Special Needs Trusts can maximize the use of government-provided services while supporting the family's care and enhancing the comfort and enjoyment of life for the disabled beneficiary.