

Adults with Disabilities: Prepare for the Future with a Special Needs Trust

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Mrs. Client has an adult son, Freddie, who resides in her home. Freddie was born with a developmental disability.¹ Freddie's grandmother wishes to give him a generous bequest in her will. Mrs. Client hopes to set up a trust so that Freddie can some day enjoy his grandmother's money, without jeopardizing his state or federal benefits.

A special needs trust² is crucial to Freddie's future. More than likely, he will someday have to face life without his parents' financial help. Without a trust, he will have to survive solely on his SSI benefits, which are well below the poverty level,³ but if he receives an inheritance outright, he will lose his SSI and Medicaid.

Medicaid covers much more than a few doctor bills for Freddie. For example, it pays for his case manager at community mental health, it covers a behavioral therapist to help him relate appropriately with others, and it makes him eligible for a host of local community services. Medicaid may even pay for his dentist, who specializes in providing care for persons with special needs.⁴

There would be no point in giving Freddie a testamentary bequest if it meant the loss of all his benefits. Then Freddie would have to use any inheritance to pay for the things Medicaid now covers. The money would be wasted without a special needs

trust; grandmother might as well bequeath it to the state of Michigan.⁵

If Freddie is lucky enough to have a trust, though, his trustee could send him to summer camp, buy him a plane ticket to Albuquerque to visit his favorite aunt, or pay the retainer for an attorney, in case of a legal emergency. (Some persons with special needs are interrogated by the police and confess to crimes that they did not commit due to their vulnerability to suggestion.)

If the money to be placed in a special needs trust originates with the beneficiary (a "self-settled" trust), special language is required for the residuary clause.

Trust money can be used for uninsured medical or dental treatments. It can pay for private rehabilitation, schooling, and recreation. It can cover ball games, camping trips, roller blades, pizza parties, vitamins, or even a travel companion. The money can assist him in reaching his maximum potential and quality of life and then eventually pay for his funeral. These are all "extras" he cannot afford on poverty level SSI income and Medicaid alone.

The hallmark of this trust is that the trustee has full discretion to spend the

money however he or she sees fit.⁶ Then a governmental agency will not be able to claim that Freddie has any legal right to the trust funds. In doing this, his creditors also should be excluded.

If the money to be placed in a special needs trust originates with the beneficiary (a "self-settled" trust), special language is required for the residuary clause. This is necessary if the beneficiary received a settlement from a lawsuit, an inheritance, or has saved up his own earnings from a part-time job.⁷ Trust language required in that situation is further explained later in this article.

The attorney should also understand Social Security and Medicaid benefits when working with Mrs. Client. By way of illustration, Freddie is 35 years old and receives SSI, or Supplemental Security Income, due to his mental disability. When his father retires, dies, or becomes disabled, Freddie will qualify for benefits under SSDI, or Social Security Disability Income, based on his father's earnings.⁸

Freddie currently qualifies for SSI because he does not have liquid assets in excess of \$2,000. Neither parent has retired, died, or become disabled. The federal government would allow him to own certain property, such as a car that does not exceed \$4,500 in fair market value or home,⁹ without losing his SSI. Freddie needs flexibility, and the trust can provide that by buying or selling a home for his benefit without affecting his Social Security benefits.¹⁰

Some day, when Freddie starts receiving SSDI instead of SSI, his assets will no

longer affect his right to receive the cash benefits. However, he will still have to keep his bank account and other liquid assets below \$2,000 to qualify for Medicaid and other services through the public mental health system.

The solution is to make sure Freddie spends the money received from SSI or SSDI on food, clothing, and shelter. If he needs something special or expensive, such as an electronic video game, the trust can buy it for him. The trust should not spend money on his food, clothing, or shelter (his basic needs), since that will be considered "income" for SSI or Medicaid purposes.¹¹

The trust should be titled the "Irrevocable Special Needs Trust f/b/o Freddie Lastname." Include discretionary language such as the following:

Under no circumstance shall Freddie have the power or authority to demand any distribution from the Trustee who is under no obligation, implied or otherwise to make any distribution to Freddie. Further, the Trustee may withhold distributions to Freddie if, in its sole discretion, they would not be consistent with intentions as expressed in this

The trust should not spend money on his food, clothing, or shelter (his basic needs), since that will be considered "income" for SSI or Medicaid purposes.

Agreement. The Trustee shall use its best efforts to avoid distributions which may cause disqualification for any entitlement to which Freddie is or may be eligible or

Trustee has full discretion to spend the trust income or principal, or not to spend it, as he or she sees fit. Beneficiary shall have no legal right to the trust assets, even in case of emergency. Any attempt by Beneficiary to assign his or her interest in the trust shall be null and void.

In addition, the trustee needs direction not to spend trust funds on food, clothing, or shelter, which would cause problems with Freddie's SSI eligibility:

To the extent that Freddie is eligible for any public benefits to provide for his basic support and maintenance, during the term of this Trust, Grantor directs that distributions

from this Trust Agreement shall be used solely for supplementing those benefits which are available to him. Inasmuch as possible, the Trustee is to administer this Trust so that Freddie's eligibility for public governmental assistance programs is not endangered.

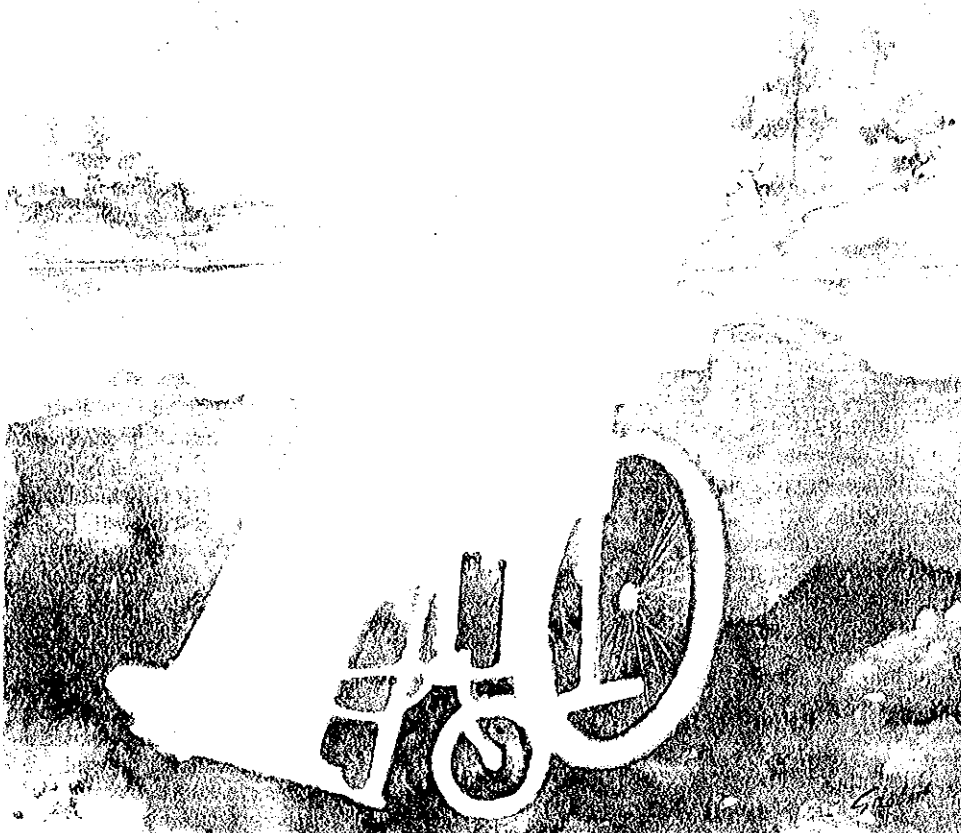
Not making a distribution for food, clothing, and shelter is especially important for SSI purposes, but Medicaid is not as strict. Either government program could consider it "income" if third parties are providing food, clothing, or shelter to a person with a disability. The rules are elaborate; SSI allows Freddie and his family to plant a garden and eat their own tomatoes without calling it "income,"¹² but if Freddie wins a cash prize for the biggest tomato at the town fair, that would be income.¹³

If the trust buys a house, it should rent it to Freddie. The rent should be low enough so that he can afford to buy his own food and clothing. Another option available to Freddie is a housing subsidy from the local community mental health agency. In sum, he should spend nearly all of his monthly Social Security check on necessities and let the trust buy the extras that enrich his life.

A wonderful byproduct of the special needs trust is that it can serve as a Medicaid planning tool for the disabled person's parent or grandparent. Suppose Freddie's grandmother needs long term care in a nursing facility. Pursuant to 42 USC 1396p (c)(2)(B), she can transfer money to a disability trust without penalty for Medicaid eligibility purposes, so long as the beneficiary is under age 65. If Freddie's Grandmother needs to qualify for Medicaid, she can do so through the special needs trust without exhausting her life savings. Plus, she will have the satisfaction of assisting Freddie by funding the Irrevocable Special Needs Trust f/b/o Freddie Lastname.

CHOOSING A TRUSTEE

A key issue for the estate-planning client is the selection of an appropriate trustee. Most often, the trust will be funded when the parents die. Should the trustee be a



close relative, such as a sibling? An agency that serves persons with disabilities, such as a local Arc (formerly known as the Association for Retarded Citizens)? A financial institution? An attorney?

In a few cases, the lucky parents will identify a close family member who is highly responsible and who cares deeply about the person's welfare. If so, that solves the problem of choosing a trustee. There should be some thought given to a successor trustee should the first choice be unable to act.

A bank or other financial institution can serve as trustee. However, financial institutions take a percentage off the top each year for administrative expenses and generally will not accept trusts with less than half a million dollars.¹⁴ Further, a bank will not know when Freddie needs special vocational services or a new fishing pole. Obviously, someone who knows and loves Freddie will have to participate in the trustee's decisions, either as an advisor or as co-trustee, even if a financial institution is appointed trustee.

It is a good policy to have a financial advisor involved in making investment decisions for the trust, but that can be done without making it the trustee.

If the trust res will not support a bank as trustee because of the high administrative overhead, consider a pooled accounts trust.¹⁵ The parent or other caregiver could have a hand in how the trust money is spent but without the hassle. Tax returns, investment decisions, and intricate rules about what is considered "income" would all be taken care of by the pooled trust administrator. Upon the parent's death, the pooled accounts trust would continue its work, and any money remaining after the beneficiary's death would be used to help other persons with disabilities in the pool.

Another possibility is a small stand-alone trust administered by a committee, to include a financial planner¹⁶ and one or two family members.¹⁷ Several close relatives, working as a team, could likely keep each other on the straight and narrow. The financial member would choose sensible investments at a minimum fee. In case one of the team members dies, the others will be familiar with the beneficiary's needs and desires. They will be ready to step in without waiting to become acquainted with the beneficiary's unique personal characteristics. The remaining trustees could even select a replacement to join their trustee

team. It may be beneficial to include a provision that allows a person to be appointed to break a "tie" should one arise.

How do the parents recognize a caring family member? Surprisingly, one of the chief characteristics of a suitable trustee is the person's willingness to speak out against the parents and argue with them about what is in Freddie's best interests. Suppose they have a niece, Janet, who sometimes makes suggestions about where Freddie ought to live or how Freddie could make more friends. That type of interference is a sure sign that Janet genuinely cares about Freddie, to the point she is willing to speak up for him. As a trustee, she would be an ideal advocate, and she ought to have a say in the administration of his trust.

Finding a trustee is not easy for most families. Anyone with a good heart and who is responsible with money has the basic qualifications.

Certain nonrelatives could be considered as candidates for the job of trustee, co-trustee, or advisor to the bank: the family pastor or rabbi, a special education teacher, or anyone else who works professionally with persons with disabilities.

In recruiting someone like Janet to serve as successor trustee, do not scare her away by suggesting that she will have to be his surrogate parent. Her job will be much more limited. She will not have to cook Freddie's dinner, but she may buy a microwave for his kitchen if he needs one.

Finding a trustee is not easy for most families. Anyone with a good heart and who is responsible with money has the basic qualifications. Once the new trustee is controlling the trust funds for the welfare of the beneficiary, the person with a disability will be light years ahead of his peers without a trust.

RESIDUAL BENEFICIARY

When the beneficiary has died, anything left in the trust should be earmarked. The money could go to the person's siblings,

just as if he or she had died intestate. Another consideration in choosing a residual beneficiary is the fact that certain agencies do a tremendous job helping persons with a disability. Some parents generously choose to reward such an agency by making it the residual beneficiary.

What if Freddie's cousin Janet serves as trustee and is also named as one of the residual beneficiaries? This raises a potential conflict of interest. Janet should be spending the money on Freddie but might theoretically feel disinclined to do so, since saving the money will benefit her (or her lineal descendants) in the end. Freddie's parents can probably avoid questions by confronting this issue openly.¹⁸

In establishing this trust, we, the Grantors, understand that the trustee is also a residual beneficiary. We believe that any technical conflict of interest is greatly outweighed by the benefit of having Janet as trustee, because we know her to be a responsible person who truly cares about Freddie.

Other protections could be built in to the plan as the facts warrant them, such as requiring an annual accounting to be reviewed by a third party or local advocacy agency. Some parents write a specific letter of intent to go with the trust.



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SELF-SETTLED TRUSTS

When a trust is funded with money that came from the beneficiary, it is a self-settled trust. This commonly happens when a person with a disability has prevailed in a legal action and wishes to place the settlement into a trust. An inheritance can create the same situation if it is placed in a trust after it is distributed by the estate to the person with a disability.

To avoid loss of Medicaid¹⁹ when establishing a self-settled trust, it is not enough to create an irrevocable spendthrift trust, even if it is discretionary. Consult 42 USC 1396p(d)(4), which explains how a trust can peacefully co-exist with Medicaid benefits. First, the beneficiary must be disabled as defined in the Social Security statute.²⁰ A parent, grandparent, legal guardian, or the court must establish the trust. The residual, after the beneficiary's death, must be payable to the state of Michigan.²¹ Here is some language to accomplish that purpose:

Upon the death of Freddie, the trustee shall distribute an amount of the remaining trust assets, principal and accumulated income, as required under 42 USC 1396p(d)(4)(A), or any regulations promulgated thereunder, or the corresponding provisions of any subsequent Federal law, to any state providing medical assistance on Freddie's behalf, equal to the total previously unreimbursed medical assistance paid on Freddie's behalf under the state's plan under Title 42 USC 1396(a) et seq., and shall forthwith distribute the balance of the trust to the person(s) and/or entity(s) designated by Freddie.

Depending on the size of the estate, it is unlikely that any money will be left over after Medicaid is reimbursed. At least the beneficiary will have the pleasure of going to summer camp and having a few other enjoyable experiences, which would not have been possible without the trust.

Another option when Medicaid problems arise for a self-settled trust is to join a pooled accounts trust for the benefit of the person with a disability. If the money is placed in a pooled accounts trust, the residual funds will be left to the trust for the benefit of other persons with disabilities. Medicaid will exclude such a trust in counting the beneficiary's financial resources.²²

CONCLUSION

Often instinctively, parents wish to treat all of their children equally. However, when it comes to a son or daughter with a dis-

ability, it may be beneficial to give a larger share of the estate to the person with a disability. A son or daughter with a disability does not have the earning luxury of his or her siblings. The person with a disability is limited to Social Security income and must depend on the generosity of family members for anything above a poverty-level existence. In splitting up their wealth for estate planning purposes, parents have a chance to look out for the welfare of a son or daughter with a disability by placing an extra helping onto that person's plate through the special needs trust.

The rest of the children will understand. ■

Footnotes

1. Some people regard the phrase "mentally retarded" as stigmatized, but it is the legally correct term, as defined by Social Security at 20 CFR Part 404, Subpart P, appendix 1, Part A, Sec. 12.05. "Developmental disability" is more politically correct, but its legal meaning includes persons of high intelligence; 42 USCA 6001(8). Practitioners are advised to use whatever language the client feels comfortable with, but stay away from the terminology used by Oliver Wendell Holmes in *Buch v Bell*, 274 US 200 (1927) ("imbecile").
2. Also known as a "discretionary trust," a "supplemental needs trust," or an "amenities trust."
3. Current SSI benefits is close to \$500 per month, which is for rent, food, and clothing. However, clearly, no single person can live a proper life independently on that income.
4. MCLA 400.108.
5. MCLA 330.1804; MSA 14.800(804).
6. *Miller v Dep't of Mental Health*, 432 Mich 426, 442 NW2d 617 (1989).
7. *In re Johannes Trust*, 191 Mich App 514, 479 NW2d 25 (1991).
8. The parent must earn enough to obtain "insured status." Also, Freddie must remain unmarried all his life to qualify for this extra bonus. The benefits paid to Freddie do not affect the amount of Social Security the father receives. If the mother earned more than the father, her earnings will be used to calculate Freddie's SSDI benefit.
9. For a complete list of assets excluded from SSI's definition of "property," see 42 USCA 1382b(a).
10. Parents desiring to ensure a permanent home for a disabled son or daughter should avoid trying to buy a home or donating a large endowment to any one residential institution. By funding a trust, the trustee can make sure the person has suitable living arrangements, depending on circumstances the parents cannot predict. Another option is the use of a charitable remainder trust.
11. See the ICLE reference work, "Michigan Guardianship and Conservatorship Handbook," especially chapter 12, which explains what constitutes "income." The book is available by calling toll-free 1-(877) 299-4350.
12. 42 USCA 1382a(b)(8).
13. 42 USCA 1382a(a)(2)(C). However, the first \$240 per year of income does not count. 42 USCA 1382a(b)(2)(A).
14. Typical financial institutions charge about one percent per year paid monthly, plus \$800. Some will not accept a trust below \$500,000; others will go down to "only" \$250,000. Some financial institutions prefer young beneficiaries, so the financial institution can build up the trust assets over the person's lifetime. Banks often shy away from trusts which own real estate for fear of environmental entanglements, despite statutory protections for fiduciary owners of contaminated property, such as 42 USCA 9607(n)(1); MCLA 324.20101(y)(ii); and MCLA 700.801(1).
15. Several nonprofit organizations in Michigan have established pooled accounts trusts, some of which are open to anyone in the state. A sub-account in a pooled accounts trust is economical and easy to set up. Contact Mark Craig of Spring Hill, (248) 276-8011, for more information about pooled trusts.
16. Typically, a stock brokerage or a CPA will serve as financial advisor for about one-half percent annually, which is less expensive than a financial institution. Another alternative: state that the trust funds must be invested with Merrill Lynch (or A. G. Edwards or Paine Webber) and can only be withdrawn by the trustees acting jointly.
17. Specify that a single trustee from the committee can act alone when dealing with third parties and that the trustees are responsible for consulting one another about decisions. Otherwise, they will have to act unanimously on every little decision, which could get cumbersome.
18. *Childs v Nat'l Bank of Austin*, 658 F2d 487 (CA 7, 1981).
19. *Striegel v South Dakota Dept of Social Services*, 515 NW2d 245 (SD 1994) (Self-settled trust vulnerable to Medicaid claim). For legal assistance in avoiding this problem, contact attorney Tom Trainer or Mary Schmitt Smith at (248) 645-9400.
20. 42 USCA 1382c(a)(3). If the individual is already receiving SSDI or SSI, he or she obviously has already met the statutory definition for medically disabled.
21. *Application of Moretti*, 606 NYS2d 543, 159 Misc 2d 654 (1993) (Self-settled trust did not interfere with Medicaid).
22. 42 USCA 1396p(d)(4)(C). For more, please review 12 Mich LW 1632, *Trust Options for Seniors & Persons with Disabilities*.