

# The Supplemental Needs Trust, a Most Powerful Tool

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## Introduction

Estate planning is a craft. In the estate planning and elder law attorney's tool-chest, the trust is a broad instrument used for the management and protection of assets. A more specialized and targeted implement is the Supplemental Needs Trust ("SNT"), also known as the Special Needs Trust. Practitioners often use SNTs to protect and manage assets for individuals with disabilities. The SNT, if properly drafted, will allow the beneficiary to qualify, or to continue to qualify, for means-tested benefits such as Social Security Income ("SSI") and Medicaid (also known as Medical Assistance).

SNTs serve a valuable public policy purpose. SNTs enhance the disabled beneficiary's quality of life by supplementing (but not supplanting) those goods and services provided by government benefits. A SNT can provide additional health care services, spending money, personal items, travel expenses, educational expenses, and housing costs not paid for by governmental programs. A properly drafted SNT creates a complementary partnership between government benefits and private wealth. Moreover, SNTs allow excellent planning that the caring third party cannot accomplish through beneficiary designation or through verbal agreements. For example, a parent, not knowing the value of a SNT, who had supported a disabled child throughout life, may leave money or property directly to a sibling with the understanding that the sibling use the assets for the disabled child, but the disabled child never benefits because of dishonesty, disagreements, greed, etc.

This article will discuss several types of SNTs, the reasons for and benefits of using each, how to set up the trust, and practical tips for the practitioner. This article will discuss the following SNTs:

- I Discretionary trusts both under the Maryland Discretionary Trust Act and those not created under the Maryland Discretionary Trust Act.
- II Federal Medicaid Law Created Trusts
  - 1) Beneficiary funded SNT, also called a (d)(4)(A) Trust (a payback trust) that allows the beneficiary to qualify for means-tested benefits.
  - 2) Beneficiary funded account, also called a (d)(4)(C) Pooled Asset Trust (in part, a payback trust) that allows the beneficiary to qualify for means-tested benefits through the use of a pooled asset trust.
  - 3) Parent funded for a disabled child SNT, also called a (c)(2)(B)(iii) Trust (in part, a payback trust) that allows both the parent and the child to qualify for means-tested benefits.
  - 4) Trust funded by third party for a disabled person under age 65 SNT, also called a (c)(2)(B)(iv) Trust (in part, a payback trust) that allows both the third party and the beneficiary to qualify for means-tested benefits.

Practitioners use Discretionary Trusts every day to protect assets for both disabled and non-disabled beneficiaries. The Federal Medicaid Law created SNTs are a creature of statute used to carve out an exception to the asset transfer prohibitions of the Medicaid rules. In the Medicaid trusts, assets of a disabled individual transferred to a trust do not penalize the disabled person for Medicaid qualification purposes.

## **I DISCRETIONARY TRUSTS**

In a Discretionary Trust, the trustee has very broad authority to limit payments of both income and principal to a beneficiary. The Practitioner may draft the Discretionary Trust under the Maryland Discretionary Trust Act (“MDTA”), Md. Est. & Trusts Code Ann., §§ 14-401 et seq. (2002 and Supp. 2007). The Practitioner must draft outside the MDTA if the settlor intends to benefit more than one protected beneficiary (protected meaning that the assets are protected under the MDTA from creditors and not considered an asset of the disabled person in applying for means-tested benefits) or if the terms of the trust would otherwise conflict with the MDTA.

Practitioners use the term “Supplemental Needs Trust” interchangeably with “Discretionary Trust” or “Discretionary Special Needs Trust.” However, in a Discretionary

Trust, the beneficiary may be, but does not have to be disabled. In a Supplemental Needs Trust, the beneficiary will be disabled. Therefore, a Discretionary Trust can be set up, in addition for a disabled beneficiary, for an individual who has spendthrift tendencies, has creditor issues, and has alcohol, chemical, gambling and other dependencies.

The MDTA gives title of the trust property and complete discretion over any and all expenditures made from trust to the trustee (§14-402(a)(1)). Trust property may not be considered property or an available resource of the beneficiary (§14-402(a)(2)) thereby protecting trust assets from creditors (except for Federal Tax Liens and those debts that the State considers duties, such as child support). The MDTA trust may be used to provide for the needs of the beneficiary to the extent not provided for by public or private programs (§14-402(b)(3)). This allows the disabled person to apply for, or to continue to receive, SSI and Medicaid benefits without the State including the trust assets as assets of the disabled individual.

#### **A) Legal Requirements.**

A MDTA trust must be settled (created and executed) and funded by someone other than the beneficiary. Practitioners often use the words “grantor” and “settlor” interchangeably as the person setting up and executing the trust. The MDTA uses the term “Transferor” (§14-401(m)). Any person who has the right to transfer property, other than the beneficiary, may create a trust under the MDTA (§14-403(a)). The beneficiary cannot be the trustee. At the time of creation, the transferor, beneficiary, or trustee must be a resident of Maryland, have her principal place of business in Maryland or the trust property must be located in Maryland (§14-404(g)). While the settlor can make the MDTA trust revocable or irrevocable, if unstated, the trust is revocable (§14-402(e)). A MDTA trust terminates on the beneficiary’s death (§14-406(a)) and the distribution of the

remainder will be paid to the remainder beneficiaries or the default beneficiaries stated in the MDTA (§14-406(b)(2)).

#### B) **Practitioner Tips**

If the settlor intends that the beneficiary qualify for means-tested benefits, and the practitioner is drafting the trust outside of the MDTA, certain language must be used, for example:

The Settlor intends this Trust to be a discretionary spendthrift trust under Maryland Law. Before making a distribution from the Trust to pay expenses, the Trustee should determine whether such expenses can be paid from government or other programs. The Trustee is directed that Trust funds are not intended to be used to pay for primary support or costs of care and services which can be provided from other sources.

The trustee must take great care in making distributions for beneficiaries receiving SSI benefits. Cash or equivalent paid directly to a beneficiary may reduce SSI payments dollar for dollar. If the trustee makes disbursements to third parties for the beneficiary's food and shelter, the beneficiary's SSI will be reduced by one-third plus twenty dollars.

Because the client may set up an estate plan and then not see the Practitioner for many years, the Practitioner must build flexibility into every estate plan to consider Discretionary Trust planning. Often, beneficiaries may become disabled, develop creditor problems or develop drug, alcohol or other addictions after the practitioner has set up the plan. Building flexibility into the estate plan allows Discretionary Trusts to be created even after the disability or death of the client. For example, an attorney-in-fact under a durable power of attorney for financial matters should have the power to create Discretionary Trusts for the client's beneficiaries. Sample language of such a power may state:

To establish, settle, fund or revoke with all or any part of my assets, any trust, revocable or irrevocable, including, without limitation, any discretionary or special needs trust for my benefit, any trust for the benefit of my children or spouse, and any trust allowable under Federal Law including (c)(2)(B)(iii) and (c)(2)(B)(iv) trusts;

In addition to empowering the attorney-in-fact, the testator of a last will and the settlor under most trusts, including revocable trusts, should empower the personal representative and trustee to protect assets by creating a Discretionary Trust for a beneficiary who has become disabled. Sample language of such a power may state:

If any beneficiary has any special needs where government assistance is required, and if any direct or indirect contribution from this Trust may jeopardize the beneficiary's ability to qualify for government assistance, then the vesting of said beneficiary's share shall be postponed until the Trustee does as follows, if possible: the Trustee is specifically empowered to place that beneficiary's share into a Discretionary Trust under the MDTA, Md. Est. & Trusts Code Ann., §§ 14-401 et seq. (2002), as from time to time amended. The terms of the Discretionary Trust shall be such terms as are provided by default under the above referenced code, as well as such other terms as are necessary in the discretion of the Trustee in furtherance of the objectives of this Trust. If required, my Trustee may seek court action to establish this Discretionary Trust.

Finally, the practitioner will find situations where the beneficiary of an existing trust would be better served if the trustee converted it to a Discretionary Trust. The practitioner can accomplish this by petitioning the Circuit Court to modify the Trust under Md. Est. & Trust Code Ann., §§ 14-106(b)(3) (2002) to protect the assets of the trust in accord with the settlor's intent.

## **II FEDERAL MEDICAID LAW CREATED TRUSTS**

Unlike the Discretionary Trusts discussed above, the statutes, regulations and requirements for the Federal Medicaid Law created trusts are complex and cumbersome. We must first start by defining several terms.

### **Definition of Disabled Individual**

Throughout this Article, the term "disabled individual" will be used interchangeably with "beneficiary." However, the Maryland Medicaid rules and regulations use the term "A/R" meaning the applicant for or recipient of Medicaid services (sometimes the term includes "A/R/S" adding the disabled individual's spouse). The Code of Maryland

Regulations defines “disabled” as the inability to perform any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuous period of not less than 12 months (COMAR 10.09.24.02 (B)(19)). If the disabled person receives Social Security Disability payments or SSI payments, the disabled individual meets the definition of disability for the purposes discussed in this article. Otherwise the Maryland State Review Team must make the determination of disability.

### **Payback Provision and Sole Benefit**

For the following trusts and accounts, the Practitioner must draft the trust with an appropriate “Payback” provision and with appropriate “Sole Benefit” provisions. The Payback provision must require that upon the death of the disabled individual or the termination of the trust, the trustee must pay over and deliver any funds remaining in the trust to Maryland, up to the amount paid in Medicaid benefits on the disabled individual’s behalf. The settlor can specify the recipient of the remainder of the assets, if any, after the trustee completes the Payback.

Most SNTs must solely benefit one disabled individual. Generally, the practitioner can meet the Sole Benefit requirement if the transfer to the trust is arranged in such a way that no individual or entity, except the disabled individual, can benefit in any way from the assets transferred to the SNT. Payments to remainder beneficiaries violate the Sole Benefit requirement. However, an appropriate Payback provision can resolve this problem.

### **The Maryland Medicaid Manual.**

The Maryland DHMH Medical Care Policy Administration prints the Maryland Medical Assistance Program Medical Assistance Eligibility Manual (“Maryland Medicaid Manual”). The Maryland Medicaid Manual provides direction to the local Area Agency on

Aging as well as to practitioners. Every elder law practitioner, or those practitioners practicing in areas touching elder law, should have an updated copy of the Maryland Medicaid Manual. The DHMH Medical Care Policy Administration issues updates to the Maryland Medicaid Manual through “Manual Releases.” The Manual Releases are available at <http://www.dhmh.state.md.us/mma/html/medassteligupdate.html>.

**1) Beneficiary Funded SNT, Also Called A (D)(4)(A) Trust (A Payback Trust) That Allows The Beneficiary To Qualify For Means-Tested Benefits.**

This Supplemental Needs Trust known as a (d)(4)(A) trust uses the beneficiary’s own assets to fund the trust. Many practitioners also refer to the (d)(4)(A) trust as a self-settled trust even though the disabled person does not create or execute the trust. Practitioners often use (d)(4)(A) trusts to hold tort recovery assets belonging to a disabled individual.

**A) Legal Requirements.**

The practitioner must draft the (d)(4)(A) trust to conform with Federal Code (42 U.S.C. §1396p(d)(4)(A)) and the Code of Maryland Regulations (COMAR 10.09.24.08-2). The Federal Statute requires that the beneficiary be under age 65 when her assets are placed in the trust, that the beneficiary meet the definition of disability, that the beneficiary’s parent, grandparent, legal guardian or a court establish the trust, and that the trust contain proper Payback provisions.

The rules under COMAR 10.09.24.08-2(C) consist of an expansive list of requirements and restrictions that the settlor must include in the trust in order for the Attorney General’s Office to approve the trust. Maryland requires approval in order for the disabled person to exclude the assets of the (d)(4)(A) trust for Medicaid and SSI qualification purposes. In most Maryland jurisdictions, if the beneficiary’s parent, grandparent or legal guardian is not available to establish the trust, the Circuit Court can

establish the trust (or order a third party to establish the trust) through a petition for a single act transaction without the appointment of a guardian under Md. Est. & Trusts Code Ann., §13-204 (2002). Assets must not be added to the corpus of the trust after the disabled individual reaches age 65. The trust must be irrevocable.

42 U.S.C. §1396p(d)(4)(A) requires the trust to have a Payback provision. Once the State is paid back, the trustee may distribute any remaining assets to those remainder beneficiaries specified in the trust. If the assets do not cover the costs borne by the State, then the State has no further recourse.

#### **B) Practitioner Tips.**

In Maryland, the drafting attorney must prepare and submit an Attorney Review and Statement Form along with the (d)(4)(A) trust to the Attorney General for approval. Currently, the Assistant Attorney General in charge of approval is Ms. Mary Sue Welcome, Assistant Attorney General, Department of Health and Mental Hygiene, 300 West Preston Street, Suite 302, Baltimore, Maryland 21201, (410) 767-5959. The Attorney Review and Statement Form serves as a checklist of those provisions required by Maryland. The practitioner fills out the form indicating the page number of each specific required provision and certifies by signing the form that the trust meets each requirement.

The practitioner will find drafting the (d)(4)(A) trust rather complicated. Not only must the practitioner carefully draft the supplemental needs provisions, but she must also abide and include the numerous requirements under COMAR 10.09.24.08-2 and the Maryland Medicaid Manual. A practitioner can find a sample form (d)(4)(A) trust on Pages 55-64 of the 2002 Cumulative Supplement of Jason A Frank's Elder Law in Maryland, Second Edition, Matthew Bender & Company, Inc. (1999 and Supp. 2002). Beware, the

practitioner should only use such a sample trust as a starting point and must update the requirements according to changes in the law and regulations.

**2) Beneficiary Funded Account, Also Called A (D)(4)(C) Pooled Asset Trust (In Part, A Payback Trust) That Allows The Beneficiary To Qualify For Means-Tested Benefits Through The Use Of A Pooled Asset Trust.**

Like a (d)(4)(A) trust, a (d)(4)(C) trust utilizes the beneficiary's own assets to fund the trust. However, in a (d)(4)(C) trust, a non-profit association establishes the trust and holds and manages the assets. The non-profit association must maintain a separate account for each disabled individual beneficiary of the trust and may pool the accounts for investment purposes.

**(A) Legal Requirements.**

The non-profit association must draft the (d)(4)(C) trust to conform with Federal Code (42 U.S.C. §1396p(d)(4)(C)) and the Code of Maryland Regulations (COMAR 10.09.24.08-2) and forward the trust to the Maryland Attorney General for approval. Maryland will not consider assets placed in the (d)(4)(C) trust a resource of the beneficiary nor apply transfer penalties to assets placed in the (d)(4)(C) trust if the following requirements are satisfied: 1) the trust must be established and managed by a non-profit association; 2) the non-profit association must maintain separate accounts for each beneficiary, but the accounts can be pooled for management and investing; 3) the account in the trust must be established by the disabled individual, a parent, grandparent, legal guardian, or a court; 4) the beneficiary must be disabled; 5) transfers to the account must be irrevocable; and 6) amounts remaining in the beneficiary's account upon the beneficiary's death that are not retained by the trust must be paid back to the State in an amount equal

to the amount paid by the State for medical assistance on the beneficiary's behalf (42 U.S.C. §1396p(d)(4)(c)).

Unlike a (d)(4)(A) trust, the disabled individual herself may create and fund the account. The Federal Statute has no age restriction, so, unlike in a (d)(4)(A) trust, disabled individuals over 65 can fund an account. However, commentators have stated concerns that Maryland, in violation of the Federal Statute, may try to impose an age restriction for those 65 and older. Currently, the Penn-Mar Organization, Inc., the Wesley Vinner Memorial Trust and the ARC of Northern Virginia are the only approved (d)(4)(C) trusts in Maryland. The First Maryland Disability Trust, Inc. has been submitted to the Attorney General's Office for approval.

The Payback provisions differ somewhat from the (d)(4)(A) trust. On the death of the disabled individual, any amounts not retained by the (d)(4)(C) trust must meet the Payback requirements. However, the (d)(4)(C) trust can retain amounts from the deceased disabled individual and use those assets for the trust purposes (for example, benefiting other disabled beneficiaries of the trust).

#### **B) Practitioner Tips.**

Some of the same issues involved in the (d)(4)(A) trust exist in the (d)(4)(C) trust. The disabled individual may still require a court proceeding if the disabled individual, her parent, grandparent or legal guardian is not available to set up the account. The practitioner must keep up on developments concerning age and other restrictions. Additionally, if the disabled individual had any hope of benefiting remainder beneficiaries on the disabled individual's death and after Payback has occurred, the (d)(4)(C) trust will not accomplish this goal.

**3) Parent Funded For A Disabled Child SNT, Also Called A (c)(2)(B)(iii) Trust (In Part, A Payback Trust) That Allows Both The Parent And The Child To Qualify For Means-Tested Benefits.**

Normally, Maryland Medicaid considers a transfer for less than full and adequate consideration from a disabled individual to a third party, whether directly or by trust, as a transfer subject to the sixty (60) month “look back” rules and asset transfer penalties. A (c)(2)(B)(iii) trust allows a disabled individual, or that individual’s spouse, to transfer assets, without penalty or look back, to a (c)(2)(B)(iii) trust for the Sole Benefit of the disabled individual’s blind or disabled child while allowing the parent to remain eligible for Medicaid. 42 U.S.C. §1396p(c)(2)(B)(iii).

**(A) Legal Requirements.**

A (c)(2)(B)(iii) trust must be created by the disabled individual or the disabled individual’s spouse with assets of the disabled individual or the disabled individual’s spouse for a blind or disabled child. The trust must be irrevocable. Maryland seems to require that the child be under age 65. However, no such federal requirement appears in the statute. Additionally, the (c)(2)(B)(iii) trust must be for the Sole Benefit of the blind or disabled child. For further discussion of Sole Benefit, see Maryland Medicaid Manual, Manual Release-140, Pp. 126-127 (2007).

**B) Practitioner Tips.**

Practitioners will find the (c)(2)(B)(iii) trust quite complicated to draft. A practitioner can find a sample form (c)(2)(B)(iii) trust on Pages 67-79 of the 2002 Cumulative Supplement of Jason A Frank’s Elder Law in Maryland, Second Edition, Matthew Bender & Company, Inc. (1999 and Supp. 2002). Beware, the practitioner should only use such a

sample trust as a starting point and must update the requirements according to changes in the law and regulations.

Additionally, the practitioner must give careful thought to whether and when to utilize such a trust. The parent may find it more beneficial to give property and assets outright to the blind or disabled child without restriction. This technique still qualifies the transfer as exempt from transfer penalties for the parent, but Maryland will consider the property and assets as owned by the blind or disabled child for the purpose of means-tested benefits. If the child is a minor, is unable to manage his finances or is receiving, or likely to receive means-tested benefits, the (c)(2)(B)(iii) trust may be the correct choice.

**4) Trust Funded By Third Party For A Disabled Person Under Age 65 SNT, Also Called A (c)(2)(B)(iv) Trust (In Part, A Payback Trust) That Allows Both The Third Party And The Beneficiary To Qualify For Means-Tested Benefits.**

Only the definition of the beneficiary changes between the (c)(2)(B)(iii) trust and the (c)(2)(B)(iv) trust. The Federal Statute states that an individual shall not be ineligible for medical assistance if assets were transferred to a trust established solely for the benefit of a disabled individual under age 65. 42 U.S.C. §1396p(c)(2)(B)(iv). The practitioner may find the (c)(2)(B)(iv) trust appropriate for a disabled individual's grandchild, sibling or other individual under age 65 who meets the definition of disability. The practitioner will find the requirements and traps for the unwary for the (c)(2)(B)(iv) trust similar to the (c)(2)(B)(iii) trust.

**CONCLUSION,**

As craftsmen and craftswomen, estate planning and elder law attorneys must consider all of the tools available to craft the perfect plan. In crafting the plan, the practitioner must build in flexibility and adaptability so that the unexpected does not cause

unanticipated consequences. As an artisan, the competent practitioner will continue to utilize the Supplemental Needs Trust as one of the best, most useful and flexible tools available to carry out the client's intent.