***TIPS AND TRAPS FOR MINORS AND DISABLED CLIENTS RECEIVING FUNDS, "PUBLIC BENEFITS AND SPECIAL NEEDS TRUSTS"*, Multnomah Bar Association, May 29, 2002**

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I. INTRODUCTION

Planning for people with disabilities often revolves around the need to access or maintain government benefits that are based on financial need ("needs based benefits").

When a person who receives needs based benefits obtains a lump-sum award or a stream of income, it usually reduces or terminates his or her benefits.

Understanding in what situations the client's benefits may be affected and possible solutions may be helpful to lawyers in several scenarios: (1) an estate planning attorney may be asked to write an estate plan that leaves a portion of the client's estate in trust to a disabled child or parent that will preserve public benefits; (2) a probate attorney may be involved in a situation in which a beneficiary is about to receive benefits that will jeopardize essential public benefits; (3) a personal injury attorney will need to carefully evaluate the effect a settlement will have on the plaintiff, or the award could hurt rather than help the client; (4) a real property attorney may be involved in helping someone sell a house, and the structure of the sale could affect public benefits; (5) an attorney may be working in a team setting with other professionals involving investment decisions, such as purchase of immediate annuities, which can permanently affect a client's government benefits; (6) a estate planning attorney may be advising a trustee of a special needs trust.

The effect of receiving a lump-sum asset as well as the effect of any scenario requiring ongoing payment of income will vary with the type of government benefits received.

II. GOVERNMENT BENEFIT PROGRAMS

A. Government Benefits Come in Many Sizes and Shapes

Some government benefits are based on disability, some on needs, some on past employment, and some on age. Knowing what government benefits the client is receiving is always the first step in identifying whether a case needs special consideration due to

those benefits. An attorney can never rely on the client to know the benefits he/she is receiving. Always require verification of the type of benefits the client is receiving.

> **PRACTICE TIP:** Have the client sign a release and request the list of benefits from the client's caseworker.

If a government benefit is not needs based or means tested, receipt of an inheritance or personal injury award will have no effect on the client's government benefits. The basic requirements for certain government benefit programs are described below. Beware that all government programs have exceptions and special categories. Only the basic requirements are described in these materials.

B. Non-Needs Based Programs

Some of the most common government benefit programs that are not needs based are as follows:

1. Social Security Retirement Benefits. Social Security Retirement Benefits is the government pension plan which pays a monthly cash benefit. Basic eligibility requirements are:

    a. Age 65 or over (age will gradually increase to age 67, age 62 for reduced benefits); and

    b. Has sufficient work history (or other wage earner on whose record the individual is entitled to draw) to qualify for insured status under Social Security guidelines.

2. Social Security Disability Insurance (SSDI). SSDI is an insurance program for disabled workers for persons under age 65 who are unable to work because of a physical or mental disability. 42 USC § 423. A disabled person is eligible for SSDI if he/she:

    a. Is under 65;

    b. Has sufficient work history (or other wage earner on whose record the individual is entitled to draw) to qualify for insured status under Social Security guidelines; and

    c. Has a mental or physical disability preventing substantial gainful activity that is expected to last for one continuous year from onset or is expected to result in death.

3. Medicare. Medicare is a health insurance program administered by the federal government for persons 65 and over and for disabled persons who have been disabled for at least two years. 42 CFR § 402. A person is eligible for Medicare if he/she:

a. Is 65 or older and is entitled to receive Social Security Retirement benefits or railroad retirement benefits; or

b. Is under 65 and has received SSDI benefits for at least 24 months; or

c. Has end stage renal disease.

4. Worker's Compensation Benefits. These are benefits paid to injured workers or their dependents for injuries or death which occurred on the job.

5. Unemployment Compensation. Unemployed workers who are able to work may receive a benefit based on payments made into the unemployment compensation system from previous employment.

C. Needs Based Programs

Some of the most common government benefit programs that are needs based programs are as follows:

1. Supplemental Security Income (SSI). SSI is a federal benefit program. SSI provides a monthly cash payment in order to provide a minimum level of income for persons who are disabled, blind or age 65 or over. 42 USC §§ 1382. A person is eligible for SSI if the person:

a. Is age 65 or over, is blind or is disabled (same disability requirements apply as for SSDI);

b. Has income which is at or below $545.00 per month or $817.00 for married couples (these numbers are inflated annually);

c. Has at or below $2,000 excluding exempt assets ($3,000 for married couples); and

d. Is not a resident of a public institution (i.e. prison or state mental hospital); or

e. Has end stage renal disease.

A person who receives SSI automatically receives Medicaid Assistance for his or her basic health care needs.

2. Medicaid Assistance for Long-Term Care. Medicaid is a joint federal-state program created to assist persons with limited income and resources to obtain long-term care. 42 USC § 1396. Long-term care includes nursing homes, assisted living facilities,

adult foster homes, and in-home care. A person is eligible for Medicaid if he/she:

a. Is an Oregon resident;

b. Is disabled (under SSDI criteria), is blind or is age 65 or over;

c. Is receiving care services at home or in a long-term care facility; and

d. Meets the financial criteria.

To meet the financial criteria, a person must meet both an income test and a resource test. Under the income test a person's gross monthly income must be at or below $1,635.00 (a 2002 amount; three times the SSI standard). (People over this income cap but otherwise eligible may still qualify by creating an income cap trust.)

The person's resources must be at or below $2,000 for single persons or for married couples below the limits provided in the Medicaid rules, which are based on a formula and are beyond the scope of this outline.

3. Oregon Health Plan (OHP). OHP is a joint federal-state program which provides basic health care including prescriptions to eligible persons. It is a part of the Medicaid program which is available in Oregon only because of a waiver received from the federal government. A person is eligible for the OHP if he/she:

a. Is an Oregon resident;

b. Meets the financial eligibility requirements:

(i) Income at or below $738.00 for an individual under the basic plan. The income limit changes depending on age and family size. OAR 461-155-0225.

(ii) Resources at or below $2,000 for single persons.

c. Cannot be receiving Medicare or SSI.

4. Food Stamps. Food stamps is a state program which provides assistance to purchase food for low income households. A person is eligible if he/she:

a. Is categorically eligible, meaning he/she is authorized to receive information and referral services and countable income falls below $1,366.00 for a single person ($1,841.00 for a married couple). This is 185% of the federal poverty level and is adjusted every April. OAR 461-135-0505(1).

b. There are no asset limits for those that are categorically eligible.

5. Public and Subsidized Housing. Many low and moderate income individuals receive assistance through federal rent subsidy programs. Rents are a percentage of monthly income, generally not more than 30%. There is no resource limit for federally subsidized housing. Eligibility is based on income, including fixed and investment income.

III. EFFECT OF RECEIPT OF LUMP-SUM OR ANNUITY PAYMENT ON NEEDS BASED GOVERNMENT BENEFITS

A. Effect on Federal Housing Subsidy

Since eligibility for federal housing is based on income, any situation in which the person will receive automatic payment of monthly income may make the individual ineligible for a federal housing subsidy or result in an increase in rent.

Since there is no asset limit for federally subsidized housing, receipt of a lump-sum will not automatically make the client ineligible. If the recipient immediately spends the assets on needed items or pays debts, then investment income will not be generated by the assets that would affect the client's monthly income. If the recipient receives a large lump-sum, and does not spend down, then the amount of investment income received or imputed to the individual will translate into increased rent or possibly even ineligibility.

B. Effect on Food Stamps

Eligibility for food stamps works in a similar manner to federal housing. Since eligibility for food stamps is based on income, a scenario designed to give the individual monthly income may make the individual ineligible for food stamps or reduce the benefits.

Since there is no asset limit for food stamps for persons who are categorically eligible, receipt of a lump-sum will not automatically make the client ineligible. If the recipient immediately spends the assets on needed items or pays debts, then investment income will not be generated by the assets that would affect the client's monthly income. If the recipient receives a large amount, and does not spend down, then the amount of investment income received or imputed to the individual will translate into decreased food stamps or possibly even ineligibility.

C. Effect on Oregon Health Plan

If the client receives mandatory income payments, either under a trust, a trust deed and note, or a structured settlement in a personal injury case, then the income will cause ineligibility for the Oregon Health Plan (OHP) if the income is over the allowed limit. If the client receives a lump-sum payment, then this may cause the client to be over the resource limit and ineligible for OHP, unless the assets are spent down or transferred to a trust.

There are currently no transfer of asset penalties under OHP, so an individual may transfer assets to another person or to a trust without causing a penalty period of ineligibility.

Although there are no specific rules that permit the creation of a trust and the transfer of assets to the trust, it appears that a properly drafted trust may effectively make the assets "unavailable" for purposes of OHP eligibility.

The timing of receipt of the benefits may be important for purposes of determining eligibility based on income as well.

D. Effect on Medicaid For Long-Term Care

Funds received by an individual needing long-term care are treated as income in the month received and an asset on the first of the month following receipt. Technically, the receipt of funds in the first month causes an overpayment, and the state agency administering the program can issue an overpayment notice.

If the recipient still has the funds on the first of the following month, and if this puts him/her over the applicable resource limit for non-exempt assets, then he/she will be ineligible for Medicaid for long-term care. There are various methods that may be used to "protect" a lump-sum.

1. Spend Down. One approach to insure that the client actually receives a benefit from the lump-sum is to spend down. This works particularly well when the client will receive a relatively small amount. The client may use the funds to purchase needed goods and services and/or to pay off any debt. Any goods purchased should be exempt assets under the Medicaid rules, such as a house, car, clothing, other tangible personal property, or a prepaid burial fund.

Timing is important, because every month that the client has funds in excess of the resource eligibility limits he/she will not receive government benefits, and the award or settlement can quickly dissipate. For example, if the client is receiving $10,000, and will be using it to purchase a car or pay off debt, then ideally he/she will have time to accomplish this before the first of the following month. If he/she receives the funds on the 30th of the month, then spend down may not be accomplished immediately, and eligibility will be affected for the month of receipt and the following month. Ideally funds from the settlement should be received at the beginning of the month in order to allow adequate time for spend down to be completed.

2. Gift. Sometimes the client wants to give away the funds. This will trigger a penalty period of ineligibility for Medicaid for long-term care. The length of the penalty period depends on the amount of the gift. A formula is used: the value of the gift is divided by $3,750.00. The resulting number is the number of months of ineligibility. The ineligibility period begins running on the first day of the month in which the gift is given. The planning

strategy is to “gift and wait.” A calculation is made to determine how much money the client can gift and how much needs to be retained to pay for care during the ineligibility period.

3. Trusts to Preserve Medicaid Assistance. In the Omnibus Reconciliation Act of 1993 (“OBRA '93”), Congress explicitly carved out two exceptions in the otherwise restrictive rules regarding trusts. The first one, called a “payback trust” or “under 65 disability trust,” allows disabled individuals who are under the age of 65 to place their assets in a trust provided certain criteria are met. Transfer of the individual's assets to this type of trust will not cause the trust assets to be deemed “available” for purposes of eligibility for Medicaid, nor will such a transfer cause a penalty period of ineligibility. The second exception allows a disabled individual of any age to transfer assets into a pooled trust. See section IV below for a description of these type of trusts.

E. Effect on Supplemental Security Income

Funds received by SSI recipients are treated as income in the month received and an asset on the first of the month following receipt, similar to the rules applying to Medicaid. Receipt of funds must be reported by the recipient. Technically, the receipt of funds in the first month causes an overpayment, and the Social Security Administration (SSA) will issue an overpayment notice. SSA typically administratively waives overpayments if they are under $500.

If the recipient still has the funds on the first of the following month, and if this puts him/her over the resource eligibility limit for non-exempt assets, then he/she will be ineligible for SSI. Even recipients of SSI who might feel that they can forego the monthly SSI payment once they have access to some other source of funds may decide that they must maintain their SSI because it automatically qualifies them for basic Medicaid Assistance.

1. Spend Down. This approach is the same as described above in paragraph D.1 above regarding the effect on Medicaid Assistance.

2. Gift. Sometimes the recipient wants to give away the funds. This will trigger a penalty period of ineligibility for SSI. The formula to determine the ineligibility period for SSI is to take the value of the gift and divide by the maximum SSI benefit (currently $545). 42 USC § 1382b(c)(1)(A). The resulting number is the number of months of ineligibility. This long ineligibility period makes gifting in SSI cases impractical in most cases.

3. Trusts to Preserve SSI. Foster Care Independence Act of 1999 changed the Social Security law to adopt the exception in the Medicaid rules which allow for “payback trusts” or “under 65 disability trusts”. These are described below in section IV.

IV. SPECIAL NEEDS TRUSTS–-FIRST DETERMINE THE SOURCE OF FUNDS

A. Generally

Special needs trusts are used to allow the beneficiary to maintain needs based public assistance and at the same time receive some benefit from the trust estate. There are many types of special needs trusts. Trusts created and funded by a third party for a recipient of public benefits are treated in some respects differently than special needs trusts that are funded with the assets of the recipient of public assistance.

Special needs trusts were developed by lawyers who realized that if a trust, by its terms, makes the trust estate *unavailable* for food, clothing, and shelter, then the existence of the trust should not affect an individual's eligibility for needs based public benefits.

Eligibility for needs based public assistance programs is determined after a review of the assets and income of the person applying for help. If assets and income are *available* to the person for food, clothing and shelter, then generally the person is expected to use the available funds for those basic needs, thus reducing his or her need for government benefits.

B. Trusts Funded With Third Party Assets

Traditionally, a special needs trust was created by a third party for a named beneficiary and funded with a third party's funds, either in a Will or an Irrevocable Living Trust. The availability of trust income and principal to a recipient of public benefits in a third party funded trust will be determined based on the trust distribution standard.

If by the terms of the trust the beneficiary is given the authority to control trust principal, either on his or her own or by directing the trustee, then the trust assets may be considered an available resource.[1] Generally speaking, a special needs trust created and funded by a third party will not be considered as an available resource. Courts that have addressed this issue look to the grantor's intent, which is evidenced in the language of the trust itself.

The grantor is not required to name the state agency to receive the remaining trust property in a trust created and funded by a third party.[2]

Under Oregon's current estate recovery rules, the remaining trust assets in a third party funded trust are not subject to recovery at the recipient's death.[3]

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[1] POMS 01120.200-D-1-b.

[2] See later discussion of the "Medicaid payback trust" for purposes of eligibility for Medicaid for long-term care and SSI, in which the state agency providing Medicaid must receive the remaining trust property to the extent assistance has been provided. However, this only applies to a trust funded with the assets of the recipient.

[3] OAR 461-135-832(14).

C. Under 65 Disability Trust or Payback Trust

Congress has passed laws intended to chill the use of trusts funded with the assets of recipients of SSI and Medicaid. An inheritance, proceeds from the sale of a home, and a personal injury or wrongful death settlement will be treated as owned by the individual for purposes of eligibility for public assistance.

In the Omnibus Reconciliation Act of 1993 (OBRA '93), Congress enacted several provisions restricting the use of trusts to qualify an individual for Medicaid for long-term care.[4] The former Health Care Financing Administration interpreted many of the provisions of OBRA '93 in its Transmittal 64. Later, in the Foster Care Independence Act of 1999 (FCIA '99), Congress enacted similar provisions restricting the use of trusts to qualify an individual for SSI.[5] Neither OBRA '93 nor FCIA '99 affect trusts created and funded by third parties, with the exception of some trusts created by the spouse of the recipient or for the sole benefit of a blind or disabled child when the transferor is trying to avoid transfer of assets penalties.

With certain exceptions, under both OBRA '93 and FCIA '99, if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the principal from which, or the income on the principal from which payment to the individual could be made, shall be considered available to the recipient.[6] OBRA '93 also created a 60-month look-back period for certain transfers involving trusts. FCIA '99 incorporates a 36-month look-back period, and does not extend this to 60 months for certain transfers involving trusts.

Congress explicitly made an exception in both OBRA '93 and FCIA '99 for disabled beneficiaries who are under the age of 65.[7] These trusts have commonly been called "payback trusts" or "under 65 disability trusts."

The key elements of a Medicaid payback trust are as follows: (a) the trust is created by a parent, grandparent, guardian/conservator, or court; (b) the individual is under 65; (c) the trust is created for the benefit of a disabled person; (d) any remaining trust balance at the death of the life beneficiary is first paid to the state agency to the extent Medicaid Assistance has been provided.[8]

1. Grantor/Trustor. Although the disabled individual is contributing the trust assets,

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[4] 42 USC 1396p.

[5] P.L. No. 106-109, December 14, 1999.

[6] See 42 USC 1396p(d)(3)(B)(i)(I); 42 USC 1396(a)(2)(6); 42 USC 1396(b)(c)(3(A) and (B)).

[7] See 42 USC 1396p(d)(4)(A); 42 USC 1382(b)(e)(5).

[8] See also OAR 461-145-540(10)(a).

he or she may not act as the grantor or trustor. The trust must be created by a parent, grandparent, legal guardian, or court. The term "legal guardian" is presumably intended to include a conservator in States like Oregon. ORS 125.440 specifically allows a conservator to create a trust, but only with prior court approval.

Probate court approval is always required when the recipient is a minor or mentally incapacitated. If a conservator has not been appointed, and no parent or grandparent is available, then a petition may be filed with the probate court to establish or authorize the establishment of a trust on behalf of the disabled individual.[9]

2. Under 65. The life beneficiary must be under 65 when the trust is created. HCFA Transmittal 64 clarified that the trust is excepted for purposes of Medicaid eligibility after the individual reaches 65, but assets of the individual cannot be added to the trust after age 65.[10]

3. Disabled. The trust must be established for an individual who is disabled as defined in the Social Security Act.[11] If the beneficiary is receiving either Social Security Disability Income (SSDI) benefits under Title II or SSI benefits as a disabled person under Title XVI, then the State will accept this determination. If the beneficiary is not receiving SSDI or SSI benefits, then the agency caseworker must make an independent determination.

4. State Receives Remaining Trust Property. The trust must provide that upon the death of the individual, any remaining trust property will be distributed to the State agency, up to the amount paid in Medicaid benefits on behalf of the individual. When the individual has received Medicaid benefits in more than one State, the trust "must provide that the funds remaining in the trust are distributed to each State in which the individual received Medicaid, based on the State's proportionate share of the total amount of Medicaid benefits paid by all of the States on the individual's behalf."[12] FCIA '99 does not require payback of SSI, but does require the payback of Medicaid. The interest of the State in the remaining trust assets by the terms of the trust is completely separate from the right of the State to estate recovery.

D. Pooled Trusts

Under OBRA '93, a non-profit organization may establish a trust in which the funds of the disabled recipients are pooled for purposes of investment and management.[13] There is no

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[9] See section VII.A. below regarding the mechanics of obtaining a court order.

[10] See HCFA Transmittal 64 Sec. 3259.7.

[11] See 42 USC 1382c(a)(3).

[12] HCFA Transmittal 64 Sec. 3259.7.

[13] 42 USC 1396p(d)(4)(C).

age limit. The exception made for pooled trusts found in FCIA '99 appears to limit their use to disabled beneficiaries under the age of 65. The assets may be contributed by a third party or the individual.

In Oregon, ARC of Oregon has formed a pooled trust, which is available to beneficiaries who have been disabled before the age of 65. The pooled trust is a professionally managed program. Funds are deposited into a pooled bank trust fund, although each beneficiary will have a separate account consisting of his/her separate share. Funds can be transferred to the ARC of Oregon pooled trust without the need for a separate trust created by a parent, grandparent, court, or conservator. For information about the pooled trust, call Mitch Teal, Pooled Trust Director, at the ARC of Oregon, (503) 581-2726 or toll-free at (877) 581-2726.

A non-profit association managing a pooled trust, such as The ARC of Oregon, can retain any remaining balance in the deceased beneficiary's account to be used for the benefit other disabled individuals. The ARC of Oregon's joinder agreement does now allow the non-profit organization to retain the funds.

This change has the potential to be of overall benefit to disabled people. Many of our clients will feel good about the opportunity to leave funds with a non-profit organization that benefits the disabled population. However, there is the potential for abuse. There may be individuals establishing pooled trusts that do not have a longstanding and demonstrated interest in serving the disabled, who would use the retained funds primarily to pay for administrative expenses such as his or her salary, with little or no benefit to disabled people.

Attorneys who are working with clients who are contemplating transferring funds to a pooled trust should advise their clients to investigate the non-profit organization managing the trust. Among the questions that the attorney or client might ask: (1) how long have you been incorporated; (2) what services do you provide to the disabled community beyond administering the pooled trust; (3) how many employees do you have and what is their experience?

This rule change has the potential to be beneficial to our client constituency. If we and our clients make appropriate inquiries, there is less chance that it will be misused.

V. DISTRIBUTION STANDARD

A. Special Needs Only

A "special needs only" standard restricts distributions to special (or supplemental) needs, expressly prohibiting distributions for basic needs. The term *special needs* suggests needs particular to the person and his or her disability, such as medical equipment or rehabilitative treatment, and usually special needs trusts do specify that distributions are

allowed for such needs.

However, a trust limiting distributions to special needs can allow distributions for anything that is not food, clothing, and shelter. This encompasses many things that are not related to a disability or medical treatment, and may not even be properly classified as a need. For example, a special need can include distributions for the cable television bill, Internet services, or vacation expenses. The term *supplemental needs* is sometimes used to perhaps more accurately describe the type of distribution that can be allowed by the terms of the trust.

Supplemental needs distributions are anything **but** food, clothing, and shelter. Typically, distributions for medical expenses are limited by the terms of the trust to medical, dental, and psychological services not otherwise covered by Medicaid.

Further examples of supplemental needs are as follows: medical insurance premiums, telephone services and equipment, transportation (including automobile, auto maintenance and repair, gasoline, auto insurance, and/or bus pass), recreation, education, pet care, subscriptions, and computer equipment and services.[14] The list of potential distributions for supplemental needs is unlimited.

Perhaps of more use is to know what is **not** considered supplemental: rent, mortgage, property taxes, heating, gas and electric power, garbage, sewer, water, fire insurance (if required by mortgage holder), clothing, and food.

A trust limiting distributions to special needs is the safest course of action to preserve public benefits now and in the future. The trustee has clear prohibitions. The government agency worker reviewing the trust is more likely to readily recognize that the trust is not disqualifying.

See Attachment A, item #1 for sample language limiting distributions to special needs.

B. Prohibiting Distributions for Basic Needs--Is It Too Restrictive?

Is it necessary to completely prohibit distributions for basic needs? While a strict special needs trust can work well for many beneficiaries, for some individuals the restrictions will limit options that could substantially increase their quality of life.

For example, we may wish to write a trust for someone who is now disabled and receiving public assistance, but who later may not be disabled and no longer need public assistance. This particularly arises when writing special needs trusts for minor children, or for individuals who are mentally ill who at some point may recover or find a treatment that helps

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[14] For more information about the operation of special needs trusts, see Wesley D. Fitzwater and Richard Pagnano "Special Needs Trusts," Oregon State Bar CLE publication, Administering Trusts in Oregon, 1995, updated 2000.

them successfully manage their symptoms. If the trust prohibits distributions for basic needs, the trustee will be breaching his/her fiduciary duty if prohibited distributions are made, even though there may no longer be a concern about whether a distribution from a trust will affect eligibility for public benefits.

As another example, the beneficiary may be receiving SSI and Medicaid, and living in substandard housing. Her parents would like to create a trust that will allow distributions for shelter, so that she can improve her living situation. The biggest concern is to maintain her Medicaid. If the trust allows the trustee to make some distributions for basic needs, then the trustee can pay for rent in a decent apartment. While her SSI will be reduced under the in-kind support and maintenance rules, she will continue to receive some SSI to pay for food and clothing, and will retain her Medicaid. (See discussion re in-kind support and maintenance in section VI.A. below.)

C. Possible Alternatives to Strict Special Needs Trust Standard

1. Discretionary Support Trust. The trust can be written to give the trustee absolute discretion to make (or refuse to make) payments for the benefit of the disabled individual. Arguably, the principal and income is unavailable because the beneficiary is unable to compel distributions for his or her basic needs. Courts that have addressed this issue look to the grantor's intent, which is evidenced in the language of the trust itself. Trust assets to which a beneficiary has no right of access (or has a limited right of access) are unavailable except to the extent of the limited actual interest.

This approach is accepted by some government agencies and in some parts of the country. The Seattle Region of the Social Security Administration, of which Oregon is a part, currently does not deny benefits to recipients of SSI who are beneficiaries of wholly discretionary support trusts. If the beneficiary cannot compel distribution under any circumstances, then the trust is not treated as a resource. Of course, an actual distribution for food, clothing, or shelter will in most cases cause a reduction in benefits.

As noted above, government agencies are prone to changing policies, often without warning. Reported cases throughout the country are mixed on discretionary support trusts , and a recent Ohio Court of Appeals case found a discretionary support trust was a countable resource under Medicaid eligibility rules. (Ct.App.Ohio, 6th, No. OT-00-048, August 17, 2001.) There is no binding precedent in Oregon on which to rely. Clifton B. Kruse, Jr., a noted elderlaw scholar and writer on this issue, has published a detailed study of these cases in his book, Third Party and Self-Created Trusts, a Lawyer's Comprehensive Reference.[15] After reviewing the cases nationwide, he offers this summary:

The right of government agencies to consider resources held in discretionary

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[15] Clifton B. Kruse, Jr., Third Party and Self-Created Trusts, A Lawyer's Comprehensive Reference, supra n. 13.

support trusts created by third parties for beneficiaries who are receiving public support has been considered in numerous state court cases with inconsistent results. Beneficiaries of such trusts who are recipients of Medicaid, Supplemental Security Income, or other public welfare may or may not be able to continue receiving their basic support from public agencies while at the same time receiving their supplemental and special needs by way of such trusts. The discretionary support trust may be deemed to be available for the support needs of the beneficiaries. The discretionary support trust is, therefore, an unreliable vehicle by which settlors may provide for beneficiaries' expenses that the state does or is otherwise obligated to pay.[16]

In short, when drafting a trust the safest course for protecting eligibility for public benefits for long-term care is to restrict distributions to special needs.

2. Purchase of Exempt Resources. A common provision in special needs trusts allows distributions for purchase of exempt resources, such as a home or car. A provision allowing transfer of the exempt asset to the individual outright, free of trust, can be included with a trust funded with third party assets. See Attachment A, item #2 for sample language.

Can distribution of exempt resources to the beneficiary free of trust be made from a payback trust? The Seattle Region of the Social Security Administration allows distribution of exempt assets from a payback trust without penalty.

3. Hybrid Approach. An intermediate approach is to clearly state that the purpose of the trust is to preserve the beneficiary's ongoing eligibility for public benefits and to provide for the beneficiary's special needs, but not to expressly prohibit all distributions for food, clothing, and shelter. The trust provisions might also expressly allow distributions for some basic needs.

Courts typically interpret trusts in light of their express purpose. With the hybrid approach, the stated purpose is to preserve the beneficiary's ongoing eligibility for public benefits, but flexibility is incorporated. This approach is clearly successful now for SSI beneficiaries in the Seattle Region, in which even discretionary support trusts are accepted. This hybrid standard is commonly used in Washington State. In Oregon, SPD now accepts the "hybrid" distribution standard.

When using this standard, it is advisable to include a provision allowing the trustee to amend the trust if necessary to accomplish the stated trust purpose, which is to preserve public benefits.

See Attachment A, item #3 for hybrid special needs distribution standard language.

CAUTION: The practitioner should exercise extreme caution when advising the

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[16] Id. pages 82-83.

client about the options. When drafting any special needs trust with a distribution standard that is not strictly limited to special needs, the effect of actual distributions should be considered. For example, if an individual is receiving Social Security Disability Income and only a small amount of SSI, then even a small distribution for basic needs may disqualify the beneficiary from both SSI and Medicaid.

VI. PRACTICAL ISSUES IN ADMINISTERING TRUSTS

A. In-Kind Support and Maintenance

1. Generally. In-kind support and maintenance (ISM) is food, clothing, or shelter or anything that may be used to acquire these necessities that is provided by a third party at a reduced rate or no cost to the recipient.[17] Thus, an individual receives ISM when he or she receives food, clothing, or shelter directly without having paid for it or receives these items because someone else pays for it.[18]

Generally, SSI benefits will be reduced in cases where the individual is not paying the full cost for his or her food, clothing, and shelter. In-kind income is normally valued at the current market rate. However, two rules govern how ISM will affect the SSI benefit: the one-third reduction rule (VTR) and the presumed maximum value rule (PMV). The composition of the household will determine whether the VTR rule or the PMV rule will apply.[19]

The VTR rule applies only when the SSI recipient lives in another person's household and receives both food and shelter from that person.[20] When this applies, the actual value of the in-kind income is not used. Rather, SSA reduces the SSI benefit by an amount equal to one-third of the FBR for SSI. The SSI benefit will not be reduced more than one-third of the FBR. The one-third reduction applies in full or not at all.

2. The Home. As stated above, the home in which the individual (or spouse or minor child) resides or intends to return to is an exempt asset for SSI and Medicaid purposes.[21] Therefore, the trust beneficiary may not be adversely affected by having outright title to a home. If the trust is a "payback trust" as recognized by federal and State law, it may be preferable to keep the home outside of the trust because the remainder beneficiary is the State that provided Medicaid assistance.

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[17] 42 USC Section 1382a(a)(2)(A); 20 CFR Section 416.1102.

[18] 20 CFR Section 416.1130(b).

[19] 20 CFR Section 416.1130(a).

[20] 20 CFR Section 416.1131.

[21] 20 CFR Section 416.1212.

On the other hand, there are often good reasons for including the home as an asset of the trust. For example, the grantor of a third-party funded special needs trust may have specifically included the home as an asset, thereby allowing the grantor to determine the ultimate distribution upon the death of the special needs beneficiary. More commonly, the home is included because the beneficiary lacks the capacity or judgment to manage such a significant asset.

Treatment of a house owned by a trust has been a source of considerable confusion. Social Security Administration helped clarify the rule regarding home ownership by a trust in the POMS issued in August, 1999. Under the POMS, a home-owning trust is not an outside source providing shelter to the beneficiary because the beneficiary "would be considered to be living in his/her own home based on having an 'equitable ownership under a trust.'"[22] However, to the extent that the trust pays for the mortgage, property taxes, homeowner's insurance and utilities from the trust assets, the PMV rule will apply.[23]

If the trust pays for improvements to the home, the individual does not receive income. Disbursements for improvements increase the value of the resource and thus do not provide ISM.[24]

3. Food. Distributions from a special needs trust for food can be treated as ISM. Are there exceptions to this? The author spoke a SSI policy analyst for the Seattle Region, Doug McSweyn, about payment of food by a trust. The policy is that "food is food." Although arguments have been made that food purchased on vacation or in the course of other entertainment should be distinguished from "basic" food, purchase by the trust of food on a trip is now considered ISM. Food that has been thrown away and rescued by the individual is not considered ISM. The unofficial policy at this time is that candy is not food. This leaves an open question about what level of nutrition is necessary to be considered food.

VII. COURT INVOLVEMENT WITH SPECIAL NEEDS TRUSTS

A. Mechanics of Court Approval of Trusts

In some instances, a disabled individual is not mentally incapacitated, and court approval is not required to fund a trust and preserve Medicaid assistance. However, court approval is required when a trust is being created for a minor or mentally incapacitated person with his or her own funds.

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[22] SI 01120.200F(1)

[23] SI 01120.200F(3)(b) and (c).

[24] SI 1120.200F.3.c

Multnomah County probate court policy is that the "presumed" vehicle for maintaining the funds from a settlement in a civil action involving minors or incapacitated adults will be a conservatorship. However, the court will consider requests involving under 65 disability trusts for individuals receiving public assistance.

In such cases, a petition can be filed under ORS 125.650(1), which allows the court to exercise any power that could be exercised by a conservator in a protective proceeding (in this case, the power to create a trust under ORS 125.440). ORS 125.650(5) also allows the court to authorize, direct, or ratify any "contract, trust or other transaction relating to the protected person's financial affairs..."

Alternatively, a petition may be filed under ORS 125.650(4) for the appointment of a temporary conservator with authority "limited to a specified time and whose power is limited to certain acts needed to implement the protective order." Under this subsection, the fiduciary "need only make such report to the court as the court may require."

Note also ORS 125.440(2), which states that the "court may not approve a trust that has the effect of terminating the conservatorship." Be prepared to explain to the court why this does not apply.

> **PRACTICE TIP:** Previously the Multnomah County probate court asked that ORS 125.650(4) be used, in which a temporary or permanent conservator is appointed to execute the trust. However, the court will now also approve trusts under ORS 125.650(1). This may eliminate a few steps in the process, although such an order is still a "protective proceeding," and many of the same procedures will apply.

B. Extending Term of Trust or Annuity Beyond Age of Majority

As noted above, ORS 125.650(5) allows the court to authorize, create, or ratify "any contract, trust or other transaction relating to the protected person's financial affairs or involving the estate of the person if the court determines that the transaction is in the best interests of the protected person." This includes the power to approve structured settlements. A conservator may authorize, direct, or ratify any annuity contract only with court approval. ORS 125.440(5).

The court will typically approve the purchase of an annuity in cases involving a minor in which there will be a full payout to the child at age 18.

May the court approve creation or funding of a trust or annuity for the benefit of a minor that will extend beyond the age of majority? ORS 125.440(2) allows the conservator to create trusts "beyond the period of disability of the protected person or beyond the life of the protected person." The term "disability" is not defined in the statute, and the term "incapacity" is used to define mental incapacity. It would appear that the word "disability" as used in ORS 125.440(2) means legal disability, which traditionally refers to both

minority and incapacity.

Matter of Guardianship of A.D.L., 506 A 2d 792 (N.J. Super 1986) is a case on point. The guardian of a minor applied for permission to use proceeds of the wrongful death settlement of the minor's father's death to purchase an annuity contract. The probate judge determined that it had no authority to permit purchase of an annuity with payments extending beyond majority. The appellate court reversed.

The court looked first to the New Jersey statute which defined the court's power over the estate of a minor or incompetent. The statute states:

> The court has, for the benefit of the ward...all the power over his estate and affairs which he could exercise...and may confer those powers upon a guardian of his estate. These powers include, but are not limited to power to...create revocable or irrevocable trusts of property of the estate which may extend beyond his disability or life...(emphasis added).

This language is similar to ORS 125.440 providing for establishment of a trust beyond the disability of the protected person.

The court acknowledged that approving the annuity would, in effect, be "impounding" the minor's estate at majority. Id at 795. Nevertheless, the court held that it had authority to grant the permission when either (1) the annuities had a provision making them terminable at majority (unless such a provision would have bad tax consequences for the ward) or (2) the court found circumstances justifying depriving the ward of absolute and unrestrained enjoyment of his estate on majority.

The court applied the following factors:

* the financial and psychological consequences of putting all or a substantial part of the minor's estate out of reach for a long period of time;
* the amount of money involved;
* the availability of other resources for current maintenance and support;
* the stability of the company offering the annuity;
* the adequacy of hedges against inflation contained in the proposed contract;
* the comparative favorability of the contract and the efforts made by the guardian to shop for alternatives;
* any special needs or vulnerabilities of the minor;

* the income tax consequences;

* the availability of a contract provision granting a commutation option upon the minor's reaching majority.

Id at 796.[25]

In practice, local rules and practices of probate courts will determine whether a court will approve a trust for a minor that extends beyond the age of majority. Some judges, in Oregon and elsewhere, do not hesitate to approve such trusts, even for minors who are expected to be capable of handling their own financial affairs upon majority, while other judges are more reluctant. Experience suggests that there is little difficulty obtaining approval from courts for trusts for minors who are disabled when there is an expectation that the minor will be unable to manage financial affairs well into adulthood and perhaps for a lifetime.

In Mills V. Durst, 594 N.Y.S. 2d 537 (Sup.1993), a New York appellate court allowed a structured settlement in which an annuity was purchased for the benefit of a seriously injured four year old. The periodic payments were made payable to the trustee of a special needs trust created for her benefit for her lifetime. The court noted as follows:

> The most significant factor in the decision as to whether or not to restrict an infant's control over settlement proceeds after the age of 18 is whether there is a reasonable possibility that the infant will become a competent adult. Here it does not appear that there is and therefore, the court should not, in a rote fashion, grant the same relief it would for a child who will presumably become a competent adult.

In this particular case, the question of whether an order depriving [the child] of control of her funds after the age of 18 would be a wise exercise of discretion also depends on factors related to [her] eligibility for Medicaid and other public entitlements....

In summary, the Oregon statute appears to allow the probate court to approve of trusts that will extend beyond the age of majority. However, the practitioner should not assume that the court will approve a trust or a structured settlement involving an annuity that will extend past the age of majority. Rather, be prepared to explain why it is desirable and in the best interests of the child. The court is likely to look favorably on cases involving a child who is expected to remain unable to handle finances in adulthood, or in those situations involving special needs trusts in which the maintenance of public benefits is essential.

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[25] Accord, Auerbach v. McKinney, 549 So 2d 1022(Fla App 1989)[no court order was required to sustain purchase of an annuity by the guardian ad litem in a settlement on behalf of a minor.] See also Hilgarth by Hilgarth v. Costello, 506 NYS 2d 267 (1986)[court not authorized to permit funds in savings bank for a minor to be transferred to a tax-deferred insurance annuity that was not federally insured.]

C. Use of Funds By Conservator for Benefit of Minor

Generally, a parent is responsible to provide an appropriate amount of support, education, care, and benefit for the minor. ORS 125.425(1). The parent should not derive personal financial benefit from the payments. ORS 125.425(1)(a). When the child has needs above and beyond normally expected living and medical expenses, the court may agree that distributions for these extraordinary needs are appropriate.

D. Modification of Existing Trusts

Oftentimes a parent dies with an estate plan which includes a testamentary trust for the benefit a child. If the child is receiving SSI, and if distributions can be made only in the sole discretion of the trustee, it may not be necessary to seek an amendment to the trust under ORS 128.135.

If an amendment is necessary, will the trust assets now be considered within the control of the beneficiary, and thus cause a disqualifying transfer unless the payback provision is included?

The current policy of the Seattle Region of the Social Security Administration is that amendment of an existing trust that does not include mandatory distributions will not be treated as a disqualifying transfer. A modification changing mandatory distributions to discretionary distributions may be treated as a disqualifying transfer.

SPD treatment of an amendment to an existing trust is less clear. An amendment that changes the character of the trust from an available asset to an unavailable asset may or may be treated as a disqualifying transfer.

VIII. PERSONAL INJURY SETTLEMENTS--SPECIAL ISSUES

If a special needs trust is contemplated in the context of a personal injury (PI) or wrongful death award, it is critical that the PI lawyer contact the trust lawyer before settling the case. The PI lawyer may obtain a good settlement or award for the client, but the client may realize little or no benefit if the process isn't handled correctly.

A. Liens

Most PI lawyers are experienced in identifying and paying liens. A thorough treatment of liens is beyond the scope of this outline. A brief reminder of some of the issues that may particularly arise in the context of public benefits and trusts are as follows:

1. Medicaid Liens. These liens arise out of ORS 416.510 to 416.610. The Third Party Recovery Unit will typically issue a lien notice. However, the PI lawyer should confirm whether there are any liens by contacting the Third Party Recovery Unit in Salem at (503)

373-0333.[26] The procedure is set out in OAR 461-195-320 and 325.

The issue of whether the use of a Medicaid payback trust obviates the need to pay any Medicaid liens until the time of ultimate payback of remaining trust property at the beneficiary's death has effectively been resolved. There is a line of cases that hold that the Medicaid lien must be paid prior to transfer of the net proceeds to the trust.[27]

2. Medicare Liens. Medicare does not issue lien notices. You must determine if your client is receiving or was receiving Medicare benefits. Part A and Part B recoveries are handled by different agencies. See Attachment B for a Medicare contact list for telephone numbers. Your first official contact with the agency should be the 1-800 number in New York. However, if you are inquiring about Part A, it is a good idea to call the local subrogation analyst and give them advanced notice that they will be contacted by the New York office.

3. Private Health Insurance. PI lawyers are familiar with private health insurance lien requirements.

The question of whether federal preemption of employee benefit plans under ERISA preempts state actions for breach of contract by a third party insurer against the insured was addressed in Great-West Life and Annuity Insurance Co. v. Knudson, number 99-1786 (January 8, 2002), *affirming* 208 F3rd 221 (9th Cir 2000). The United States Supreme Court held in a 5-4 decision that ERISA does not authorize a claim for reimbursement under these circumstances. ERISA does authorize equitable relief, but the court did not characterize a breach of contract action as equitable relief. Interestingly, the Knudson case involves a Medicaid payback trust.

In an Oregon case on point, Providence Health Plan sued one of its insured under an employer group health plan for failure to reimburse. In a January 29, 2002 opinion, Judge John Jelderks held:

> Whatever the outer limits of ERISA preemption, I see no way to avoid the conclusion that an action to enforce the provisions of an employee benefit plan is a claim relating to an employee benefit plan. It is regrettable that, in the wake of Knudson, Providence may be left without a remedy, but that does not alter this conclusion."[28]

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[26] See Chapter 6, "Getting the Best Recovery for Your Client: Liens and Other Recovery Issues," from the April 10, 1998 Oregon Law Institute program: Handling Claims for Minor and Disabled Plaintiffs: Coordinating All Aspects of the Case. Materials include article by Cynthia L. Barrett, attorney, entitled "Private Health Insurance and Payback Practice Tips" as well as materials provided by federal and state employees about Medicare and Medicaid liens.

[27] Cricchio v. Pennisi, 683 N.E.2d 301 (N.Y. 1997), Medica v. Billingslea, 618 NW 2d 616 (Minn.App.2000)

[28] Providence Health Plan v. McDowell, Civil No. 01-1704-JE, Opinion and Order dated January 28, 2002.

Judge Jelderks further concluded that a remand to the state court would be pointless because the "state court would have little choice but to conclude that all of Providence's claims are preempted."

This issue should not be considered resolved. The author is involved in an Oregon case in which the state court held that the insured under an employer group health insurance plan was required to reimburse the insurer. The net proceeds were transferred to a Medicaid payback trust, and by the terms of the trust are not available for reimbursement. This case is on appeal.

4. Risks When Trust or Annuity Involved. When the net proceeds will be paid to a Medicaid payback trust with the State Medicaid agency as the payee at the death of the beneficiary, both the trust lawyer and the PI lawyer are at risk if the liens are not paid prior to transfer of the net proceeds to the trust.[29] There are numerous complications that can arise when a lien is not fully paid and the funds are no longer in the control of the beneficiary or the lawyers. This can also be an issue if virtually all of the net proceeds are used to purchase an annuity.

B. Structured Settlements

There are special issues to consider in cases involving a structured settlement.

1. Trustee as Life Beneficiary. If the claimant or the conservator is named as the direct beneficiary of an annuity purchased in the context of a structured settlement, then it could cause him or her to permanently lose eligibility for public benefits. If the payments are "unassignable" then some government agencies will treat them as received by the individual each month even if the payments are contributed to the trust. Therefore, it is essential that payments be made directly to the trustee.

2. Estate Taxes. A structured settlement with a large payout and a long-term certain may trigger an estate tax problem. If the life beneficiary dies before the term certain has expired, the present value of the periodic payment stream may, in combination with any other assets in the minor's estate, exceed the unified credit. The Internal Revenue Service takes the position that the present value of the remaining term is included in the estate. LTR 9530002 and LTR 9622035. In such situations, estate tax planning counsel should be consulted.

In some cases, the settlement may be arranged in such a way as to name a contingent payee to receive payments in compensation for his or her own injury. Also, it may be possible to implement other planning tools to minimize estate taxes, such as an irrevocable life insurance trust, for claimants who are eligible for life insurance coverage.

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[29] See Great-West Life and Annuity Insurance Co. v. Knudson, number 99-1786 (January 8, 2002). Affirming 208 F3rd 221 (9th Cir 2000).

Another option is to discuss a commutation rider for a structured settlement annuity to provide cash for payment of estate tax if the need arises. It may also be an option to go directly to the company and ask for a lump-sum payout to liquidate the right to future payments.

Last, there are "liquidation" companies that will pay to acquire the rights to the future payments, of course at a substantial discount.[30]

3. Timing. It is possible that an award or settlement will be treated as an available resource during the pendency of a proceeding in the court to establish a trust.

These outcomes can both be avoided if the PI lawyer recognizes the problem sufficiently ahead of the settlement to engage the trust lawyer. The trust lawyer can then identify whether the beneficiary is in fact receiving needs based government benefits, help the PI lawyer and the injured party decide on a plan, and then obtain court approval, if needed, prior to or contemporaneous with the settlement.

IX. TRUSTEES

Who should be named to act as trustee of the trust?[31] It is an important initial decision. One commentator said it all:

> Trust administration is not for every personality and every ethic. It is not for the wheeler-dealer and the dabbler. A trust is a legally complicated relationship, often requiring sustained attention over a period of many years, to a myriad of details of which some are clerical in nature...and some are not....Stewardship over someone else's property in and of itself is serious business, and yet it is only one of the trustee's many nondelegable functions.[32]

A. Trustee for Special Needs Trust

There are additional considerations when selecting a trustee for a supplemental needs trust. First, if the beneficiary is disabled, he/she may have **unique** needs, and the trustee should be prepared to be familiar with what those needs are. Particularly, if the beneficiary is also mentally incapacitated, he/she may not be able to communicate his/her needs.

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[30] See *Structured Settlements and Periodic Payment Judgments*, Law Journal Press, Section 2.05[3] for a more complete discussion of estate tax issues.

[31] For an excellent discussion of this topic, see Laurie Neilson Lee, Trustee Selection and Succession, Administering Trusts in Oregon, Oregon State Bar CLE, 1995.

[32] See Loring, A Trustee's Handbook, Little Brown and Co., 1997.

Second, the trustee must also be familiar with the complex rules governing public benefits, so as not to make distributions that may be improper under the terms of the trust but will jeopardize public assistance.

When the trust is funded with a significant amount of money, a trust committee or co-trusteeship involving both a professional/corporate trustee and a member of the beneficiary's family is often a good solution. Thus, the professional trustee can focus on investments, tax returns, and accounting issues, while the family member can focus on the beneficiary's needs. Frequently the trustee hires a lawyer for advice about appropriate distributions.

Often a special needs trust is funded with a relatively low amount of assets, and paying a professional trustee is not cost-effective. If a family member will serve as trustee, the attorney should take extra precautions to insure that the trustee understands his/her duties.

B. Trustee of Minor's Trust

It is problematical to name a parent as a trustee of a minor's trust. It raises the specter of a parent distributing funds in a manner that may benefit the parent more than a minor. To mitigate this, a parent should generally not serve as sole trustee or have sole authority as a co-trustee to make distributions.

In addition, the trust can provide that the trust is not intended to replace the parents' obligation to support the child. Last, the trust can include a provision requiring the trustee to provide frequent accountings to the beneficiary and/or third parties who can review the distributions for conformity with the purposes of the trust.

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