

Establishing the Special Needs Trust: How to keep your win from becoming your client's loss

Avoiding great hardship for a client who receives certain public benefits requires careful planning

By Kevin Urbatsch

Establishing a first-party Special Needs Trust

Because a person with a disability is not allowed to establish his or her own (d)(4)(A) SNT, determining the correct procedure to establish the trust is often a very difficult task. The choice of the proper procedure depends on a number of variables, the most critical of which are whether:

- There is a parent, grandparent or legal guardian willing to assist, or, if not, whether a court order can be obtained;
- The person has capacity; and
- The person is a minor, age 18 or over but under age 65, or age 65 or over.

For a plaintiff who is 65 years of age or older, it is not possible to establish a (d)(4)(A) SNT due to its age requirement. For these plaintiffs, it is required that SNT alternatives be considered or they join a Pooled SNT.

Establishing a (d)(4)(A) SNT through court for plaintiff who is a minor or incapacitated adult under the age of 65

There is only one situation in which a first-party SNT must be established by the court; i.e., if a minor or incapacitated adult with a disability receives a litigation recovery and is also the recipient of needs-based public benefits (Prob. Code, §§3600–3613). When there is a compromise, covenant, or judgment for a minor or adult with a disability, an SNT is but one of several options available for distributing the funds by court order. The SNT, however, is the only method of distribution for preserving eligibility for needs-based public benefits.[1] This is the most expensive and time-consuming way to establish an SNT.

Ed. Note: This is the second part of a two-part article.
This month – Establishing the Special Needs Trust (SNT) and a look at the alternatives to the SNT.
See April issue to learn: When and why an SNT is required.
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The SNT is established by a court petition, either as an attachment to a minor or incompetent's compromise or as part of a separate petition in Probate Court. The petition must seek an order of the court that makes the following findings (Prob. Code, §3604(b)):

- The minor or person with a disability has a disability that substantially impairs the individual's ability to provide for his or her own care or custody and constitutes a substantial handicap. For practical purposes, a person who qualifies for SSI or Medi-Cal on the basis of disability is likely to satisfy the substantial impairment requirement.
- The minor or person with a disability is likely to have unmet special needs without the trust. Depending on the amount at issue, many personal injury attorneys have a "life-care plan" prepared for the plaintiff. The life-care plan can be used as an exhibit to the petition to establish the SNT that the amount paid is not only reasonable, but in all likelihood insufficient to meet all of the future "special needs" of the person with a disability.
- The amount paid to the trust appears reasonably necessary to meet those special needs. The term "special needs" suggests a category of needs that is narrow or somehow limited in scope. However, just the opposite is true. The term "special needs" is distinguished from "basic needs," that is, the needs for food, shelter and medical care, which public benefits like SSI and Medi-Cal are intended to provide for minimally. "Special needs" then encompasses the very broad range of anything and everything else a human being needs in order to live, thrive, and realize his or her potential in life.

The practitioner may satisfy this requirement by describing the prospective "special needs" of the SNT beneficiary such as accessible housing; supplemental medical, dental, vision, and mental health care; supplemental nursing and custodial care; supplemental therapy, rehabilitation, training, and education; special equipment; and medically directed dietary supplements; furnishings and household goods and supplies; access and repair services for telephone, television, Internet, cable, and computer; household

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and yard cleaning, maintenance, and repair services; clothing; transportation needs, including gasoline, auto expenses, insurance, public transportation costs and travel fares; personal care, including hair, skin and nail care; athletic, artistic, outdoor and other recreational programs; instruction, supplies, and equipment, including televisions, cameras, computers, software, compact disks, DVDs, books, magazines, and newspapers; musical, artistic, writing and printing instruments; and admission to movies, concerts and other performances and activities that enhance quality of life or self-esteem; memberships to clubs and associations; and pre-need funeral and burial expenses.

In addition to the requirements described above, SNTs established under Probate Code sections 3600–3613 must also comply with the requirements for court-funded trusts set forth in California Rules of Court, rule 7.903(c).[2] Thus, the trust document must contain certain provisions regarding bond, court-supervised accountings, and restrictions on trustee changes and trust modifications, investment standards, and payment of trustee and attorney fees, among others, unless good cause is shown.[3]

Some practitioners mistakenly believe a (d)(4)(A) SNT must be established for all litigation recoveries using the Probate Code section 3600 procedure. However, the court cannot make an order or give a judgment under Probate Code sections 3600, 3601, 3602, 3610, or 3611 without the express consent of a *person who has capacity*.[4] In other words, the adult with capacity may elect to use other means to establish an SNT. Not consenting to the Probate Code section 3600 procedure is generally in the best interest of the SNT beneficiary who has capacity because the trust will not have to comply with the requirements of California Rules of Court, rule 7.903, which mandates expensive ongoing court supervision, a trustee bond, court-supervised accountings, and court authorization for payment of trustee and attorney fees.

Establishing a (d)(4)(A) SNT through a parent or grandparent for a plaintiff who is an adult with capacity under the age of 65

It is possible for a disabled adult *with capacity* and with a parent or grandparent willing and able to assist to establish a qualifying (d)(4)(A) SNT for a benefit recipient's litigation recovery. This type of SNT is called a "seed trust." It is so-called because a parent or grandparent establishes a (d)(4)(A) SNT for the benefit of a child or grandchild with a disability by funding the trust with a nominal amount of his or her own funds (e.g., $10 on a Schedule A), thereby "creating" the trust under Probate Code sections 15200 and 15202. The parent or grandparent who signs the (d)(4)(A) SNT document is taking physical action required by POMS SI 01120.203(B)(1)(e) to "establish" the trust. Once the seed trust is established, the adult person with a disability who has capacity can transfer (or fund) his or her own assets to the trustee of the trust.[5] This procedure satisfies the legal requirement that a parent or grandparent must establish the SNT. This type of trust is generally preferable to the expensive Probate Code sections 3600-3613 procedure described above and is generally the most efficient way to establish an SNT.

Establishing a (d)(4)(A) SNT through court for a plaintiff who is an adult with capacity under the age of 65

Many practitioners have successfully used an attorney-in-fact petition under Probate Code section 4541 to obtain a court order establishing a (d)(4)(A) SNT for a person with a disability who is age 18 or over, under age 65, has capacity, but has no parent or grandparent able or willing to assist. For an adult with a disability who has capacity but no parent or grandparent able and willing to assist, a Probate Code section 4541 petition is nearly always preferable to consenting to the Probate Code sections 3600–3612 procedure.[6] The Probate Code section 3600 procedure is generally more burdensome because of the additional findings of fact required in the petition and the express requirement that the expensive court supervision requirements of Rule 7.903 requirements must be applied to a trust funded through that procedure. There are some courts, however, which will not authorize this petition so it is important to know the jurisdiction in which the trust is being established.

Selecting the appropriate trustee

The biggest decision with a (d)(4)(A) SNT is choosing an appropriate trustee. Putting the wrong person in charge can defeat the entire purpose of the trust. Inexperienced or conflicted trustees can mismanage funds, spend on inappropriate items and violate the rules of vital public benefits programs. A family member may be less resistant than an independent trustee to the entreaties of the beneficiary for distributions, even if those distributions will too quickly deplete the trust corpus.

It is often preferable to have a professional trustee serve as trustee of an SNT, whether a private professional fiduciary or a bank, that is experienced in this role. SNTs require professional investment management, accounting, recordkeeping and compliance with other fiduciary duties to the beneficiary. Professional trustees solve the problem of potential conflicts of interest and undue influence from beneficiaries and family members. They can also act as a buffer between family members and beneficiaries. The drawbacks of using a professional trustee include their cost, a potential for unresponsiveness, and their lack of availability for smaller trusts. However, this cost is generally offset by a professionally managed SNT that will generally not fail in its intended purpose.

Joining a Pooled SNT

The second type of "safe harbor" first-party SNT is a pooled SNT. This type of trust works well for some individuals

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who do not have a large enough litigation recovery to establish a separate (d)(4)(A) SNT or are age 65 or older. Typically, a person with a disability (or one of the other entities authorized in the statute to act on that person's behalf) will join an existing pooled SNT run by a charitable organization by executing the pooled SNT's joinder agreement and transferring his or her assets to the trust. As long as all rules are strictly followed, such a transfer can be made without causing any public benefits disqualification.

Although each individual has a separate account maintained on his or her behalf, the funds of all beneficiaries are pooled together for investment purposes to provide aggregate investment fee discounts, hence the name "pooled SNT." By law, the pooled SNT must be "established and managed" by a nonprofit association, though the actual investment and distribution tasks can be, and often are, delegated to specialists. Currently, there are seven Pooled SNTs being run for California residents that have a wide range of cost and services.

Unlike a (d)(4)(A) SNT, a pooled SNT:

• Does not impose an age limit for the prospective beneficiary (42 USC §1396p(d)(4)(C)). The plain language of the statute seems to indicate that a pooled SNT may be established for the benefit of an individual 65 years of age or older. However, the transfer of assets to a pooled SNT by a person 65 years of age or older *may* trigger a transfer-of-assets disqualification for both SSI and Medi-Cal support for long-term care.

• May be established directly by the person with a disability. A benefits recipient with capacity may establish his or her own account with the pooled SNT without any third-party involvement. It can be a major advantage for an adult individual with a disability who has capacity to enter into a joinder agreement but does not have a parent or grandparent able or willing to assist with the establishment of a (d)(4)(A) SNT or much enthusiasm for the expense and uncertainty involved in seeking a court order to establish such an SNT.

• Has no mandatory payback provision. The pooled SNT instead requires payback only "to the extent that amounts remaining in the beneficiary's account upon death of the beneficiary are not retained in the trust."[7] Under the plain language of the federal statute, if the trust retains the undistributed trust account assets, there is no requirement to pay back the state. In spite of the broad language of the federal statute, the California Department of Health Care Services takes a much narrower view of the purposes for which funds can be "retained in trust."[8] In effect, it imposes a payback requirement almost identical to the one required for SNTs created under (d)(4)(A).

• Is usually already in existence and may be joined on short notice to shelter disqualifying property;

• Does not require identification and training of an individual trustee.

Ongoing administration of a Special Needs Trust

Once the SNT is established, the assets held in the trust will not disqualify the plaintiff from his or her public benefits. However, the plaintiff must understand the limitations of an SNT. The hardest thing about this planning is describing the limitations placed on the funds in an SNT. If distributions from the SNT are made in an inappropriate manner, they can still jeopardize benefits. Thus, it is important that the plaintiff understand what types of distributions can be made. For example, a first-party SNT must only be used for the "sole benefit" of the primary beneficiary during his or her lifetime.[9] It is very difficult to explain to an SNT beneficiary or his or her immediate family that assets in a first-party SNT cannot be used to support a minor child or spouse. Even a simple gift of $100 to a child is forbidden. In addition, another limitation is that the SNT cannot give cash directly to an SNT beneficiary. Under the SSI program, beneficiaries must report all income received each month and lose a dollar of benefit for every dollar of income over $20 a month. This includes distributions from his or her SNT. There are numerous other limitations, so it is prudent that the practitioner understand and guide the plaintiff through these issues before he or she consents to the establishment of a first-party SNT.

Summary

A plaintiff who receives a litigation recovery should be advised of his or her ability to preserve needs-based public benefits and preserve the use of the litigation recovery. It is important that a qualified special needs planning attorney assist in designing, establishing, and administering a first-party SNT for a plaintiff with a disability. All too often, the litigation recovery is not properly planned for and the person with a disability gains little or no benefit from the recovery.


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Endnotes

[1] Prob. Code, §§ 3602(d), 3611(c).
[2] Cal. Rules of Court, rule 7.903(a)(1).
[3] Cal. Rules of Court, rule 7.903(c).
[4] Prob. Code, § 3613.
[5] Prob. Code, § 15200(b).
[6] Prob. Code, § 3613.
[7] 42 USC, §1396p(d)(4)(C)(iv).
[8] 22 Cal. Code Regs., § 50489.9(a)(4)(E).
[9] 42 USC, §§1382b(c)(1)(C)(ii)(IV), 1396p(c)(2)(B)(iv), and 22 Cal. Code Regs., § 50489.9(a)(4)(F).

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