**15TH ANNUAL CHANGES AND TRENDS AFFECTING SPECIAL NEEDS TRUSTS**
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# Understanding the Fundamentals of Self-Settled Special Needs Trusts

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# UNDERSTANDING THE FUNDAMENTALS OF SELF-SETTLED SPECIAL NEEDS TRUSTS

## I. INTRODUCTION: THE FOCUS OF THIS PAPER

Since passage of the Omnibus Budget Reconciliation Act of 1993[1], the use of Supplemental Needs Trusts (also known as Special Needs Trusts or "SNT") has grown to such proportions that just about every practitioner has heard of the trust but there is still much confusion about the terms and reasoning behind a SNT. The intent of this author is to define a SNT, set out when it is generally used, list some strategies for creating the trust and a brief discussion of the tax implications of the trust, with a particular focus on self-settled special needs trusts.

## II. THE SUPPLEMENTAL NEEDS TRUST

**A. DEFINITION.** A supplemental needs trust is a broad term encompassing self-settled and third-party created trusts. It is a trust created for an individual with the intent of allowing distributions from the trust to the beneficiary while the beneficiary has the option of maintaining eligibility for governmental "need-based" benefits.

The operative words describing this trust are "supplemental needs", thereby distinguishing this trust from a "support" or other type of trust. Other words used to describe the supplemental needs trust are instructional, such as a limitation that trust distributions should "supplement and not supplant" governmental benefits. SNTs may have very strict distributions restrictions prohibiting certain distributions. More broadly, SNTs may give the trustee full discretion to make distributions, even to the extent of causing the beneficiary to forfeit governmental benefits, if it is determined that such strategy is in the best interest of the beneficiary.

**B. BRIEF HISTORY OF THE SUPPLEMENTAL NEEDS TRUST.** Practitioners have always taken legal steps to draft trusts so that the beneficiary does not forfeit valuable governmental need-based benefits. The Medicaid program has long been one of the most regulated of the "need-based" programs and therefore, the SNT sprang from Title XIX of the Social Security Act.

1. Prior to June 1, 1986. The Medicaid program was originally established in 1965. It was designated Title XIX of the Social Security Act, found at 42 U.S.C. §1396 et seq. The purpose of the Act was "to provide medical assistance to persons whose income and resources are insufficient to meet the costs of necessary care and services."[2] In the early days, a person receiving or anticipating the use of governmental benefits would attempt to meet the low asset requirement by transferring assets into a trust for him/herself. Few of these trusts successfully protected benefits, as

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1 42 U.S.C. §1396p.

2 *Sanders v. Pilley*, 684 So.2d 460, 464 (La. 1st Cir. 1996) writ denied, 691 So.2d 90 (La. 1997), citing to *Atkins v. Rivera*, 477 U.S. 154, 156, 106 S.Ct. 2456, 2458, 91 L.Ed.2d 131 (1986).

common law and public policy prohibited a person from placing his assets in trust to the detriment of creditors.[3]

However, some case law held that if the beneficiary never had possession of funds that funded a trust, then the trust would not be considered grantor created.[4] Therefore, petitioners in a personal injury suit would have the court or defendant apply any recovery directly into a trust so that the beneficiary never actually had possession of those funds.

Texas regulations address trusts created prior to June 1, 1986. A Medicaid Qualifying Trust *disqualifies* an applicant for Medicaid assistance.

> "(a) A Medicaid-qualifying trust (MQT) is a trust that a recipient, the recipient's spouse or guardian, or anyone holding the recipient's power of attorney establishes using the recipient's money. The recipient is the beneficiary of an MQT. A trust meeting this definition that was established between June 1, 1986, and August 10, 1993, is an MQT. **A trust meeting this definition that was established before June 1, 1986, is treated as a standard inter vivos trust.**"[5](author's emphasis)

If a trust is an inter vivos trust, it is defined in the Texas Administrative Code as

> (a)(2) A trust established while the person creating the trust is still living. (b) Resources in a testamentary or inter vivos trust are countable to a person if the person is the trustee and has the legal right to revoke the trust and use the money for the person's own benefit. (1) If a person does not have access to the trust, then the trust is not counted as a resource. (2) If a person's access to a trust is restricted (that is, only the trustee (other than the person) or the court may withdraw the principal), then the value of the trust as a resource is not counted, even if: (A) the person's legal guardian is the trustee; (B) the trust provides a regular, specified payment to the person; or (C) the trust provides for discretionary withdrawals by the trustee. (3) If a trust is not counted as a resource, payments from the trust made to or for the benefit of the person may be counted as income only if the payments would ordinarily be counted as income in accordance with 20 CFR § 416.1102 [noting that cash and payments for food or shelter are countable income to an individual].[6]

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3 *See, e.g, Vanderbilt Credit Corp. v. Chase Manhatten Bank*, 473 N.Y.S.2d 242, 246 (A.D. 1984).

4 *See, e.g., Kegel v. State,* 113 N.M. 646, 649, 830 P. 2d 563, 566 (1992) holding that a personal injury award that was directed by a guardian pursuant to court order were not funds belonging to the individual beneficiary.

5 1 Texas Administrative Code §358.337.

6 1 Texas Administrative Code §358.336.

# Title search: Understanding the Fundamentals of Self-Settled SNTs

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