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Watch Your Step: Special Needs Trust Drafting and Administration, Errors and Omissions

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INTRODUCTION

This paper will review the most common drafting errors and omissions that hinder the Trustee of a Special needs trust (SNT) from providing the trust beneficiary with their best life experience, as well as some administrative recommendations. Special needs trusts are the unicorn of all trusts. The typical and most general purpose of a special needs trust is to enhance the quality of life of the trust beneficiary, while preserving the beneficiary's eligibility for public benefits. When drafting special needs trusts, it is important that SNTs are written to include the necessary requirements for such trusts. There are many common mistakes made by drafting attorneys and this paper will cover some of the most common drafting errors or omissions, as well as some beneficial advice regarding the administration of special needs trusts.

TYPES OF SPECIAL NEEDS TRUSTS

Federal law provides that trusts for beneficiaries who are currently receiving certain public benefits (such as SSI and Medicaid), or who may qualify for public benefits in the future, meeting certain standards are exempt from being considered a countable resource, thus protecting the trust beneficiary's public benefits eligibility for most major programs. These types of trusts are often identified as special needs trusts. Without a properly drafted special needs trust to protect and preserve the trust estate, the trust beneficiary will be ineligible for means tested public benefits or, if they are already receiving public benefits, they will lose their eligibility. It is important to note that not all public benefits programs are protected through the use of a special needs trust.

While this paper will not be an in-depth explanation of the nuances or drafting requirements of special needs trusts, it is important to discuss the types of special needs trusts and the differences between each type. A legal practitioner without a strong understanding of the differences of each type of special needs trust will most unavoidably make mistakes that could be detrimental to the public benefits eligibility of the beneficiary of a special needs trust. There are two types of special needs trusts, self-settled trusts and third party funded trusts.

Self-Settled Special Needs Trusts (First Party Funded Trust)

A self-settled special needs trust is a trust funded with the assets of the trust beneficiary. This type of trust may be referred to as a self-settled special needs trust, Medicaid payback trust, OBRA '93 trust, and a d4A or d4C trust.[1] Such a trust is for the sole benefit of the trust beneficiary (under the age of 65), who has a qualifying disability, containing the assets of the trust beneficiary and will not be considered an available resource to the trust beneficiary. A self-settled special needs trust must be irrevocable, or it will be considered an available resource to the beneficiary.[2] The source of funds for this type of trust can come from many different sources. Most commonly these trusts are funded with personal injury settlements, accidental inheritances, child support, or some other source of funding that the beneficiary had a right to prior to transferring to the trust.

If the trust is established and funded prior to the trust beneficiary attaining the age of 65, the trust's exemption as a resource will continue if the trust beneficiary continues to meet the disability criteria.[3] It is important to note that "no additions or augmentations to the trust after the person becomes age 65" are permitted, as such an occurrence will be considered a transfer of assets.[4] However, as a practice note, there is an exception pertaining to payments to trusts from structured annuities purchased prior to the beneficiary attaining the age of 65.

According to 42 U.S.C. § 1396p(d)(4)(A) the trust must be established for the sole benefit of the beneficiary by the *individual*, a parent, grandparent, legal guardian of the beneficiary, or a court.[5] The Special Needs Trust Fairness Act of 2015 made the long-awaited change allowing persons with a qualifying disability who otherwise had the capacity to create their own trusts, the ability to do so. Prior to the Fairness Act, adults with capacity had to look to the other qualifying individuals to create their own trusts. Such unequal treatment was not only demeaning to the trust beneficiary, but often subjected the beneficiary to unnecessary legal costs.[6]

A self-settled special needs trust ***must*** include a payback provision to the State up to the amount paid by each State under the Medicaid program for services to the beneficiary. [7]

> *"The trust must include a provision that the state is designated as the residuary beneficiary to receive, at the person's death, funds remaining in the trust equal to the total amount of Medicaid paid on their behalf."* TEX. MEPD F-6710

However, careful consideration should be given when drafting payback language. There are some Medicaid programs provided for under Title XX that do not have such a required payback.[8] Thus, the careful drafter may want to include in the trust agreement that the payback is limited *to an amount equal to the total amount of Title XIX Medicaid paid on behalf of the beneficiary*.[9]

Self-settled special needs trusts can also be established pursuant to 42 U.S.C. § 1396p(d)(4)(C). These trusts are self-settled special needs pooled trusts. Pooled trusts are created and managed by a nonprofit organization. These trusts allow for the economical joint management of the assets of individual beneficiaries. The assets of the trust are combined and invested together and managed by a single trustee for the benefit of numerous individual trust beneficiaries. Each beneficiary has a separate subaccount for their proportion of the total trust investments. The individual subaccount is also subject to a payback provision to the State up to the amount paid by each State under the Medicaid program services to the individual beneficiary.[10] Pooled Trust accounts qualify for the same resource exemption as those of a (d)(4)(A), but must be established and managed by a non-profit association, maintain a separate account for each trust beneficiary, for the purpose of joint investment and management of the trust funds.[11]

Third-Party Settled Special Needs Trusts

Third-party special needs trusts are often created by persons planning for a loved one with a disability. A third-party settled special needs trust is a trust created by someone other than the trust beneficiary and funded with assets that are not those of the trust beneficiary. These trusts can take several forms, they can be an inter vivos trust or they can be a testamentary trust set up as part

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