

INTRODUCTION TO POOLED SPECIAL NEEDS TRUSTS

By Michael J. Drabant and Scott Nixon

Estate planners, litigators, financial planners, and other professionals from time to time find themselves in a dilemma when it comes to planning for a client or family member with a disability who is receiving means-tested government benefits. If the person with a disability is to receive a lump sum of money from a settlement, a child support payment from divorce, a Social Security back payment, or an improperly planned inheritance, the individual could be at great risk of losing critical government benefits. For purposes of special needs planning, we are mostly concerned with people on means-tested benefits such as Medicaid and Supplemental Security Income (SSI).

The dilemma for professionals can go beyond the lump sum of money itself. Not only do they need to consider the setup of some type of specialized exempt trust, but the size of the lump sum may not be large enough to consider setting up an individual trust. Often times, estate planning professionals will look to a corporate trustee who is competent and reliable to manage a special needs trust according to today's standards. However, many corporate trustees have minimum amounts that must be satisfied before agreeing to manage any trust. This is where pooled special needs trust can be a useful tool. They can fill the gap where the amount of funds in the trust is not sufficient to satisfy the minimum requirements by many corporate fiduciaries. This article will examine the basics of special needs planning, a description of the different types of special needs trusts, and the details and functions of pooled special needs trusts.

ASSET LIMITS

For many years the asset limit for Medicaid was \$2,000, but this amount was recently changed to \$17,500.¹ This means Medicaid recipients in Illinois cannot have more than \$17,500 worth of “countable resources.”² Certain assets are exempt and therefore not countable towards the asset limit. These types of assets include a prepaid burial plan, life insurance with a cash value of up to \$1,500, a vehicle, and personal property items.³ Despite the change in the Medicaid asset limit, it should be noted the asset limit for SSI remains at \$2,000 for an individual.⁴ When preparing an estate plan, practitioners should avoid bequests of outright distributions to a person with a disability. If a person is on Medicaid and they receive a large sum of money from an inheritance, it will push them over the asset limit, thereby disqualifying them from their government benefits. This is the reason special needs planning is so important for beneficiaries who have a disability.

TYPES OF SPECIAL NEEDS TRUSTS

There are two main categories for special needs trusts: third-party special needs trusts and first-party special needs trusts. The primary difference between these two categories is how the trusts are funded. A third-party special needs trust is one which is funded with someone’s assets other than the person with a disability. A first-party special needs trust is funded with assets belonging to the person with the disability. One other distinction between the two categories of special needs trusts is the existence, or lack thereof, of a “payback” provision to the state. This will be discussed in further detail below.

THIRD-PARTY SPECIAL NEEDS TRUSTS

The following is a common example for the use of a third-party special needs trust: A married couple has a child with a disability who is receiving Medicaid and SSI. The couple wishes

¹ Ill. Admin. Code tit. 89 § 120.382.

² Id.

³ Ill. Admin. Code tit. 89 § 120.381.

⁴ 20 C.F.R. § 416.1205 (c).

to provide financial security for the child after their deaths while ensuring the child can still qualify for government benefits. The third-party special needs trust is the ideal solution for this scenario. The couple will create the third-party special needs trust, which can be funded during their lifetimes or after their deaths. Often times the couple will be the co-trustees during their lifetimes. Then, after their deaths, the funds are then managed by an independent trustee who can make distributions that *supplements* the beneficiary's government benefits. It's important to note that third-party special needs trusts are not required to be irrevocable during the grantors' lifetime. The distributions from the trust are usually made to cover expenses which are not being provided by the beneficiary's government benefits.

FIRST-PARTY SPECIAL NEEDS TRUSTS

As previously mentioned, a first-party special needs trust is one which is funded with the assets of the beneficiary. There are two common scenarios when these types of special needs trusts are used. The first is when a person with a disability receives funds from a lawsuit. The second is when the person with a disability receives an inheritance that was either unexpected, or where the family member did not properly channel the funds through a third-party special needs trust.

The Omnibus Budget Reconciliation Act of 1993 ("OBRA '93") set a new precedent under the Social Security Act and for Medicaid in consideration of assets poured into any non-special needs trust. These assets would broadly be considered an available resource for SSI and Medicaid eligibility purposes. However, under the OBRA '93 Act there were three excepted trusts to this rule. The three exceptions under OBRA '93 are the following: OBRA (d)(4)(A) first-party payback trust, a (d)(4)(B) self-settled trust (Miller trust, income protection trust), not used in Illinois; and a (d)(4)(C) pooled trust.⁵

⁵ 42 U.S.C. §1396p(d).

The unique provision of a first-party trust is that it has a “payback provision” to the State upon the death of the beneficiary.⁶ The trustee is required to reimburse all states which have paid medical assistance (Medicaid) during the beneficiary’s lifetime.⁷ Only after the state has been reimbursed may the trustee distribute assets to the remainder beneficiaries. All first-party special needs trusts fall into one of two categories: (d)(4)(A) trusts and (d)(4)(c) trusts.

OBRA (d)(4)(A) FIRST-PARTY PAYBACK TRUST

One type of first-party trust is called the OBRA (d)(4)(A) first-party payback trust, also referred to as the (d)(4)(A) trust. This is named after the federal statute 42 U.S.C. 1396p(d)(4)(A). For this type of trust, the trustee may be either an individual, corporate, or non-profit organization.⁸ In order to establish this type of trust, the following requirements must be met: (1) The beneficiary must be under age 65, (2) the beneficiary must have a disability, (3) the trust must contain a payback provision to all states which provided medical assistance to the beneficiary, and (4) the trust must be created by either the individual, parent, grandparent, legal guardian, or a court.⁹ One additional requirement is that the trust must administered in such a way that no person or entity other than the specified beneficiary can benefit from the trust.¹⁰ This is commonly referred to as the sole benefit rule.

HISTORY OF POOLED TRUSTS

Many are unaware that pooled trusts were in operation before there were any federal laws. The Ray Graham Association, as a service provider in DuPage County for individuals with intellectual and developmental disabilities, created a pooled trust program called *The Self-*

⁶ 42 U.S.C. §1396p(d)(4)(A).

⁷ Id.

⁸ Id.

⁹ Id.

¹⁰ Ill. Admin. Code tit. 89 § 120.388(m)(2)(B).

*Sufficiency Trust of Illinois.*¹¹ The Self-Sufficiency Trust of Illinois was the first of its kind in the country. The Ray Graham Association put together a legislative package with the State of Illinois that ultimately passed as legislation in 1986. Several states soon followed Illinois' lead and set up their own version of the Self Sufficiency trust program in South Dakota, Montana, and Alaska, which are all still in operation today.

In 1988, the ARC of Indiana established their own pooled trust called the ARC of Indiana Master Trust to allow families to provide for their loved ones. ARC-run organizations had been instrumental going back to the early 1990s in establishing pooled trust programs in many states across the country.

All these earlier "Pooled Trust" programs were started by a nonprofit association. These early pooled trust programs were set up as a third-party pooled special needs trust. The programs were like a traditional third-party special needs trust, but using a pooled investment plan. The grantor of a third-party trust could provide a lifetime of additional supplemental care needs for a beneficiary with disabilities without loss of public benefits. On the death of the beneficiary, there were no requirements on a third-party pooled trust to "reimburse" or "payback" the state for any Medicaid costs but could be designated to other family members or charities.

OBRA (d)(4)(C) FIRST-PARTY POOLED PAYBACK TRUST

We will now examine the current standards for first-party pooled payback trusts. OBRA '93 established the creation of the OBRA (d)(4)(C) first-party pooled payback trust.¹² The primary principals of this trust is that the trust assets must be funded only with the assets of an individual.¹³ The (d)(4)(C) first-party pooled payback trust must be established for a person with a disability

¹¹ 20 ILCS 1705/21.1. The Self-Sufficiency Trust Fund, created under repealed Section 5-118 of the Mental Health and Developmental Disabilities Code.

¹² 42 U.S.C. §1396p(d)(4)(C).

¹³ Id.

under United States Code Title 42, Section 1382c(a)(3) and any other federal or state law related to means-based government programs for people with disabilities.¹⁴

Much like the (d)(4)(A) trust, this trust must comply with the “sole benefit” rule established under the Illinois Administrative Code.¹⁵ The trust document must also contain a payback provision upon the death of the beneficiary to pay for any medical expenses received in their lifetime through Medicaid.¹⁶

Under OBRA '93 a nonprofit organization must establish and maintain full management control over the pooled trust.¹⁷ It is common for a nonprofit association managing a first-party pooled trust to hire for-profit agents, such as investment advisors, to act on behalf of the nonprofit board to manage the trust assets. However, the nonprofit must always maintain full control over the for-profit agents it hires in order to remain in compliance with the rules and regulations governing these types of trusts.¹⁸

DISTRIBUTIONS AFTER DEATH OF BENEFICIARY

A payback provision is required on every first-party special needs trust, whether individual or pooled.¹⁹ This is the most significant difference between a third-party trust and a first-party trust. The payback provision must require the payback of the remaining balance of the first party trust to the state Medicaid agency to the extent the state has incurred expenses.²⁰ This can include more than one state if the beneficiary received Medicaid services in their lifetime in other states. This includes all expenses throughout the life of the beneficiary, and the state must be listed as first payee over the trust upon the death of the beneficiary.

¹⁴ 42 U.S.C. §1382c(a)(3).

¹⁵ Ill. Admin. Code tit. 89 § 120.388(m)(2)(B).

¹⁶ 42 U.S.C. §1396p(d)(4)(C).

¹⁷ Program Operations Manual System SI: 01120.203(D).

¹⁸ Id.

¹⁹ 42 U.S.C. §1396p(d).

²⁰ Id.

There are only a few things allowed to be paid out of a first-party Special Needs Trust prior to paying back the state Medicaid agency according to the Program Operations Manual System (POMS) established by the Social Security Administration. These items would include taxes due from the trust to the state or federal government due to the death of the beneficiary.²¹ It also includes any reasonable fees for the administration of the trust estate, such as an accounting of the trust to the court, completion and filing of documents or other required actions associated with terminating or wrapping up the affairs of the trust.²² There are other payments upon the death of the beneficiary that are not allowed such as taxes due to the estate of the beneficiary, funeral expenses, inheritance taxes, payment of debts to third parties and payments to residual beneficiaries.²³

LOGISTICS OF POOLED TRUSTS

In a way, a pooled-special needs trust is like a combination of a 401(k) and a traditional special needs trust. The pooling aspect of the trust is the setup of the investments. Another term used in pooled trust management is commingling of the assets for multiple beneficiaries. Pooled funds, like mutual funds, are "unit trusts" or a "communal" type of trust. This means that beneficiaries deposit funds into the pooled trust in exchange for "units" of that fund, or simply a percentage of that pool, which reflects the beneficiary's pro-rata share. To add under the OBRA '93 federal law, the trustee must maintain separate accounts for each beneficiary in the pool.²⁴ The pooled trust is administered as "one" investment fund for management efficiency and does provide costs savings as result for both trustee and beneficiaries. The pooled trust accounts are referred to as sub-accounts.

²¹ Program Operations Manual System SI:01120.203(E)(1).

²² Id.

²³ Program Operations Manual System SI:01120.203(E)(2).

²⁴ Program Operations Manual System SI:01120.203(D)(4).

Families and beneficiaries using a pooled trust do not use their own trust documents. They use the pooled trust documents referred to as a “joinder agreement” or “transfer agreement” to join or transfer funds to an already existing pooled trust fund.²⁵ The existing pooled trust fund is established by the nonprofit association using a “master trust document”. The pooled trust distributions are handled in very much the same way as traditional special needs trust with more restrictions than a third-party special needs trusts.

CONCLUSION

Many nonprofits of pooled trusts are closely connected to local and national disability-related networks and organizations. Pooled trusts can vary greatly in size and services, but most provide a litany of information about setting up a pooled trust, finding a qualified attorney, securing public benefits, money management, housing, care planning, and trust distribution guidance. Most pooled trusts organizations today are often available to act as trustee over individual third-party special needs trusts, OBRA (d)(4)(a) first-party payback trusts, and OBRA (d)(4)(C) first-party pooled payback trusts. For estate planning professionals, pooled special needs trusts are a useful tool when the individual trusts are not a viable option because of the amount of funds or the management needs for the trust assets.

²⁵ Program Operations Manual System SI:01120.203(D)(1).