

Special Needs Trusts for Family Members with Mental Illness

Summarized by Thomas T. Thomas

What is the best way to plan for a disabled family's future? When we're gone, how can we arrange for their financial needs without jeopardizing Supplemental Security Income (SSI), Medi-Cal, and other benefits. On May 23, we brought back

Linda S. Durston, PhD, a local attorney who specializes in these issues.



LINDA S. DURSTON, PHD

Durston works in the probate area—estate planning; setting up special needs trusts (SNTs), guardianships, and conservatorships; trust administration; and some actual probate cases. About half of her practice is creating and administering SNTs for clients. She noted that as a lawyer's career develops, she begins by setting up trust documents early in her practice and then administering them later in her career. Durston maintains a law office at 1604 Solano Avenue, Berkeley (510-526-1375, lsdurston@aol.com) and said she welcomes

questions from NAMI members. “Call me,” she said. “I’ll give anyone fifteen minutes of free advice.” But from her work on probate, she warned, “The best time to do estate planning is while you’re still alive.”

A special needs trust is a specific kind of spendthrift trust that allows the beneficiary—the person for whom the trust is set up—to enjoy the use of certain economic assets and resources and still qualify, or retain eligibility, for needs-based public benefits like Supplemental Security Income (SSI), Medi-Cal, Section 8 housing, and In-Home Supportive Services (IHSS). The SNT is generally designed to enhance the beneficiary's quality of life by providing goods and services that are covered not at all, or only inadequately, by SSI and Medi-Cal. Generally, to be eligible for these public benefits in California, a person may not have more than \$2,000 in resources. The public benefit under SSI is intended to cover food and shelter,¹ and so the trust assets may not be used to provide these necessities without reducing the SSI benefit, although there are exceptions to this rule.

Setting up an SNT has additional benefits, because it provides:

- Assistance to the beneficiary in managing his or her money.
- Advocacy and support in managing public benefits like housing, SSI, and Medi-Cal.

¹ Previously, clothing was also a necessity covered by SSI, but this provision has since been changed. So family members or the SNT can provide gifts of clothing without decreasing the public benefit.

- Advocacy in caring for the beneficiary.
- Flexibility to modify the trust document to reflect future changes in the law.

Durston said there are two kinds of SNTs—first party and third party. They are distinguished by the source of the money and other resources put into the trust.

A first-party SNT is funded with the beneficiary's own money—usually from an inheritance, distribution from a litigation, or assets accumulated earlier in life. The beneficiary must be younger than age 65 when the trust is established. By Federal law, this kind of SNT can only be set up by a parent, a grandparent, a legal guardian or conservator, or a court. If there is no parent or grandparent, or if the beneficiary is under a conservatorship, then the SNT must be established by a court and must be supervised² by the court, with court-approved accountings in the first year after establishment and then every two years after that. “Under court supervision,” she said, “the accounts must balance penny for penny, and Alameda County will make sure the trust is set up properly.” This kind of trust is generally more expensive, especially if established by a court, because it requires the trust administrator—the trustee—to be covered by a performance bond. Then, if there is malfeasance, the bonding agency pays off the beneficiary and pursues the trustee.

Durston noted that the costs of establishing an SNT through the court varies from \$5,000 to \$7,500, depending on various factors, including the jurisdiction. The cost of court accountings can be \$1,000 to \$2,000 or more, depending on how the trust has been managed.

The first-party SNT must be for the sole benefit of the grantor—the beneficiary—and is irrevocable from its establishment. Under these conditions, following the death of the beneficiary the first-party SNT is also required to use any remaining assets, after allowing for legal fees and taxes, to pay back to the state the costs of any services provided under Medi-Cal during the beneficiary's lifetime. SSI and IHSS benefits are not included in this payback, Durston said, and the cost of Medi-Cal services to the state is usually less than a person would otherwise be paying for medical treatment. Anything left after this payback may be distributed to surviving relatives or to charity.

Under the rules for a first-party SNT, the beneficiary's inherited funds may alternatively be put in a pooled trust operated by a not-for-profit group. In this case the beneficiary may be over the age of 65—although the law is ambiguous and this point is under dispute. The beneficiary must be disabled under the Social Security Administration's rules for receiving public benefits, and in this case old age counts. The point of a pooled trust is that when the beneficiary dies, the trust funds are then used by the pool to help other disabled people. NAMI California operates such a pooled trust.

A third-party SNT is set up by someone other than the beneficiary and uses the trust maker's own money—usually as part of the estate planning process—to leave assets for the beneficiary without jeopardizing his or her access to public benefits. “Any one can set up a third-party trust,” Durston said. “A

² The policy on supervision is currently at issue, and an exception may apply for trusts created by an agent working under a power of attorney and approved by the court.

parent can set one up for a child, a child for an aging parent, or a sibling or best friend acting on behalf of the disabled person.” There are no age limits; a court is not involved—unless something goes wrong; and the trustee is not required to be bonded. The assets in the trust may also be structured to benefit more than one individual, and there is no payback requirement. So, a third-party SNT can be arranged to take care of a disabled individual and then, upon his or her death, transfer the assets to a sibling or other named person. However, the third-party SNT is also irrevocable at the point at which it is funded, such as at the death of the trust maker.

One of the frequently asked questions is who should be the trustee to administer the trust—a family member or a professional? Some of the issues are cost; available time and attention; skills, fidelity, exposures, and tax issues. Durston said that as time goes on, she often sees better results with professional trusteeship. A family member who might be the ultimate inheritor of the funds under a third-party SNT is set up for conflict. “When people fight and both sides want lawyers,” she said, “then there go the assets.”

To pick a trustee, she recommends working with an attorney who does a lot of SNTs and has ongoing relationships with fiduciaries and bank trust departments; knows how they work; and knows whom to trust. If the person wanting to set up a third-party SNT lives in one state, say California, but the beneficiary lives in another, say Massachusetts, then the trustee will necessarily be living and working in, and the trust will be governed by the laws of, the state in which it is administered—Massachusetts. Durston recommends that the trust be structured so that it will work in both states. For assistance in identifying attorneys in another area, she recommended the National Academy of Elder Law Attorneys (www.naela.org). “A little bit of attorney time spent on this can save some money down the road.” She recommends interviewing at least three professional trustees before picking one.

In California, professional trustees charge approximately \$100 per hour. However, if the beneficiary is capable and can say what he or she needs, then the administration may amount to no more than an hour once a month writing four or five checks. Professionals can also deal with quality of life issues and calls for help that family members may not be prepared for. There are also tax implications if the trustee is a family member and dies before the beneficiary, because the trust assets may end up in an estate and become taxable. The income to the beneficiary may then be taxed—although possibly at a lower rate, depending on what’s held in the trust. A nonprofessional trustee may also cost the beneficiary in terms of stress and conflicted relationships.

If there’s concern about turning the whole matter over to a professional, then the SNT can be structured so that a family member receives an accounting of the trust assets and has the power to fire the trustee if necessary. Similarly, the beneficiary can be allowed to hire and fire the trustee.

Another frequent question is whether the house in which the beneficiary lives should be passed outright through inheritance or put into the SNT. The answer, Durston said, is it depends. One of the largest concerns is whether the beneficiary is mentally and emotionally capable of managing a house, or might, for example, give it away or invite in unreliable associates. Other issues include

exposure to creditors, including Medi-Cal during a first-party SNT payback process; lack of control over the asset, including unwelcome guests in a rental situation; and insufficient funds to pay for taxes, insurance, and maintenance.

If the house generates income, such as from rental as part of a duplex, then that income will go into the trust if the house is part of an SNT. There it can be used to pay property taxes, insurance, and maintenance. But if it is owned outright, the income will go to the beneficiary and so reduce the SSI benefit. Currently, an SSI beneficiary can transfer a house without triggering a transfer disqualification and can avoid Medi-Cal estate recovery.

How does an SNT affect Section 8 housing benefits? Money from the trust will be counted in the annual analysis performed by the housing authority to determine the amount of benefit to be paid. This may raise the rent a bit, but creates more value for the beneficiary. In a first-party SNT, the money is counted for two years.

Another frequent question is whether the assets in the SNT can be used to pay the beneficiary's food, shelter, and other necessities. These basic needs are supposed to be covered by SSI. If the beneficiary is receiving both SSI and Medi-Cal, then the trust should pay the rent directly to the landlord, not the beneficiary, and the SSI benefit will be reduced by a fixed amount, currently, \$221 per month, rather than dollar for dollar. This may be a good deal for the beneficiary, as there will be more of the monthly income available for food. "Generally, if the trust is going to pay for necessities," Durston said, "it's best to have it pay for one thing or the other, food or shelter." However, if the beneficiary is only receiving Medi-Cal but not SSI (as, for example, support is paid by Social Security), then different rules apply, called in-kind support and maintenance (ISM), and the trust is allowed to pay for shelter.

People also ask if the SNT can pay for travel expenses. This issue is complicated, Durston said, and takes some planning. Some airline tickets are allowed under public benefits, and some are not. The difference is between losing all benefits for the month, or only losing a fixed amount, currently \$271, for the month.

What happens to the SNT if the beneficiary gets well and can return to work? If that is a probability, then a first-party trust can be structured to avoid initiating the payback process, and a third-party trust can be restructured by the court. Of course, one should allow for the likelihood that the beneficiary will have a relapse and need to go back on public benefits.

If the parents of a disabled beneficiary are divorced, do they have to set up separate SNTs? "The first concern should be the benefit of the child," Durston said. It's possible to establish a single trust and, if the third-party contributors want the assets they put in to be handled differently after the beneficiary dies, then keep them in separate accounts. Or two trustees can work under a single trust. "This just requires a few provisions in the trust document," she said.

And finally, if the amount of money available is too small to justify establishing an SNT, what are the other options? Durston said that an inheritance can be used in several ways for the beneficiary without disqualifying him or her for public benefits. For example, to:

- Pay off debts.
- Purchase exempt assets, such as a car.
- Buy furniture.
- Repay burial expenses of the trust maker.
- Prepay for certain services, such as rent.
- Contribute to a pooled trust.

The beneficiary can also give away inherited assets in order to preserve benefits. However, transferring property can cause the beneficiary to be cut off from SSI for three years, although he or she would continue to get Medi-Cal benefits.

At this point, Linda Durston opened the discussion to the audience's questions.

Q. What kind of training does a fiduciary require?

Fiduciaries tend to be independent and small. This year, following some incidents of conservators scamming elderly adults, California's rules on conservatorships have changed, and the courts have raised their education requirements. The Professional Fiduciary Association of California (www.pfac-pro.org) handles the education of professional conservators and trustees. Durston said the trust document needs language to cover the possibility of the named trustee being no longer able to serve. "If you want to be safe," she said, "go with a bank trust department. A bank lives forever." She said that the Mechanics Bank has an "awesome" trust department, but they have a minimum trust size—on the order of \$1 million, but that may include real property. Westamerica Bank has a \$250,000 minimum but charges 1.25% of the asset value per year.

Q. To provide housing for my disabled child, rather than give my house or put it in trust, can I give it to sibling and put conditions on it with a life estate to the beneficiary?

A life estate divides interest in an asset on the pattern of "to A for A's lifetime, then to B." On the death of one beneficiary the property automatically reverts to the survivor, and you don't have to go to court. This can go wrong if the secondary beneficiary—the disabled child's sibling—dies first, and the property will go into probate if both children die at the same time. In a life estate the primary beneficiary has all the "incidents of ownership"—that is paying for taxes, maintenance, etc.—and if these are not provided for, the property reverts to the secondary beneficiary.

One solution might be to grant the disabled child a right to occupancy, but this has less teeth than a life estate. Also, it's not fair if one child has the right to live on the property, but the other has the ownership and the obligation to maintain it. You need to provide fairly—for example, giving the second child a grant of money to maintain the property. But it still might be better to set up a third-party SNT with provision for disposal of the property after the beneficiary dies. Problems always arise when children don't feel they are getting equal treatment. It can tear a family apart.

"Keep it simple," Durston advised. "A special needs trust creates a way out rather than give everything to one child and then obligate him or her to take care of a disabled sibling."

Durston noted that she and fellow attorney Kevin Urbatsch would be giving a seminar, “Special Needs Trusts: Planning for the Disabled in California,” on July 25, 2007, in San Francisco. The seminar is a function of Lorman Education Services (www.lorman.com). However, she said, it is designed for professionals: attorneys, accountants, financial and estate planners, insurance professionals, paralegals, and trust officers.