

Planning for a Family Member's Future: the Special Needs Trust

Summarized by Thomas T. Thomas

How can we plan for our mentally disabled son or daughter's future after we have gone? One answer is the special needs trust (SNT). But people have questions about this tool: How do you set one up? What are the requirements and duties of the trustee? Will the beneficiary lose Social Security, Supplemental Security Income (SSI), Medi-Cal, and other benefits? The speaker at our May 25 meeting, **Linda S. Durston, PhD**, is a local attorney who specializes in wills and trusts, estate planning, elder law, trust administration, conservatorships, and SNTs.

Durston began by saying that, although she did not plan to talk in depth about Social Security and SSI—which are complicated enough for a presentation in themselves—she was familiar with their laws through her early work with the Hawkins Center in Richmond, California. The center is a not-for-profit that helps people qualify for benefits under these programs due to a medical or mental health disability. Knowledge of the requirements is essential, however, to her ability to create special needs trusts for her clients.



LINDA S. DURSTON, PHD

“A special needs trust,” Durston said, “permits a person with a disability to qualify for SSI, Medi-Cal, and in some cases Section 8 housing support and at the same time enjoy a standard of living in excess of these programs’ financial limitations.” SSI, she explained, is a needs-based public benefit for people with a qualifying disability that provides approximately \$800 per month, intended to pay for the beneficiary’s housing and food. With SSI comes access to Medi-Cal, which provides free medical insurance to cover doctor’s visits, medication, hospitalization, and long-term nursing care—all of which are valuable for a person with a mental illness.

SSI includes restrictions on the person’s income and access to resources. Currently, the recipient may have no more than \$2,000 in the bank and receive no more than \$20 a month in cash. An SNT enables the person to qualify and still have assistance from money—such as from an inheritance or disability claim—for “special needs,” which are in excess of food and shelter. Under the terms of the trust, the person has no ownership or control of the funds, which are handled by a trustee who disburses them for the benefit of the disabled person. As the beneficiary has no control, Social Security has ruled that the funds do not belong to the person and so he or she still qualifies under the program.

What are special needs? Generally, things that enhance the quality of a person’s life: phone and cable service, education and entertainment, books, musical

instruments, transportation and travel, a computer, a television, clothing, household goods and furniture, and anything else that the trust can pay for without adversely affecting the beneficiary's qualification. Trust disbursements may also provide for medical care not provided under Medi-Cal's basic coverage, such as additional hours of in-home support services, personal care such as hair and skin treatments, manicures, and pedicures. The trust may also provide for dietary supplements without reducing the benefit for food, provided that the beneficiary has a note from his or her doctor.

Three changes in the Social Security rules came into effect on March 1, 2005, which affect the provisions of a special needs trust:

- Clothing was previously included in the \$800 amount along with shelter and food. So any purchase of clothes for the beneficiary was considered disqualifying income, had to be reported, and the monthly SSI assistance was reduced accordingly. Clothing is no longer covered; so parents and friends can buy clothes for the beneficiary without jeopardizing his or her financial qualification.
- A car valued at no more than \$4,500 was previously all that the beneficiary could own—unless it was used for transportation to a doctor's appointment or for grocery shopping. Since everyone uses a car for these purposes, among others, Social Security removed the limitation and now a beneficiary may have a car of any value.
- Household goods—furniture, clothes, art—were previously limited to \$2,000 in total value. As value is difficult to judge (e.g., the replacement purchase price? the garage sale price?), Social Security removed this limitation as well.

The SNT may provide for the beneficiary's housing under certain circumstances. It may not pay the person's rent directly, as that would be disqualifying income and reduce the monthly benefit. However, the trust may own a house, condominium, or other real estate of any value and provide it as a residence for the beneficiary's use. So long as the trust owns the property (and it should be funded adequately to provide for upkeep such as property taxes, insurance, and maintenance), Social Security does not consider this provision of shelter as in-kind income. If the SNT purchases a house for the beneficiary's use, that event must be reported by the tenth day of the month following the purchase. The value of the property will then be considered in-kind income and effectively reduce the SSI benefit to zero—for that month only. A month later, when the house becomes a resource within the trust, the beneficiary is reinstated under SSI.

Social Security has the right to audit the special needs trust and its disbursements, and so the trustee must keep good records. As a general rule, the trustee does not distribute to the beneficiary cash or checks—more than the SSI limit of \$20 per month—or provide assets that can easily be turned into cash. Also, the trustee is not allowed to reimburse the beneficiary for purchases he or she has already made. So the trustee pays the phone and cable bills directly from the trust, buys a computer or other item and turns it over to the beneficiary, buys plane tickets and turns them over, and so on. "The relationship between the trustee and the beneficiary is very close," Durston said.

In establishing an SNT, it's important to distinguish between first-party trusts and third-party.

A first-party trust is set up with funds originally owned and controlled by the beneficiary, such as from an inheritance or a disability claim. Only four types of people can set up a first-person SNT for a beneficiary: a parent, a grandparent, a legal guardian, or a court. If a parent or grandparent sets up the trust, the proceeding does not have to be handled through court; if a legal guardian or a court sets it up, however, then the proceeding is handled through a court. Also, if the beneficiary does not have the capacity to decide about disposing of his or her assets to a first-person SNT, then the proceeding must go through court.

According to new, more restrictive rules as of January 1, 2005, first-person SNTs established through a court must have an accounting to the court at the end of the first year, and then every two years thereafter. "You must be prepared to have lawyers in your life forever," Durston commented.

Another restriction on a first-person SNT is disposal of the remaining trust assets after the beneficiary dies: Social Security and the state take the assets as reimbursement for benefits provided during the individual's lifetime.

And finally, a first-party SNT may only be established for a beneficiary under 65 years of age.

A third-party SNT, on the other hand, is established, usually as part of estate planning, with assets belonging to one person to be set aside for the benefit of another. Thus, a parent can set up a third-party SNT for a disabled child, or an adult child can set one up for a disabled parent. There are no age restrictions, no requirement to involve a court and its costs, and no restriction on disposal of funds after the beneficiary dies. The SNT can state how remaining assets are to be inherited or donated. A yearly accounting is required of the trustee, but it does not have to be reviewed and approved by a court.

Setting up a third-party SNT is usually done through a will or revocable living trust, in which case funds are not available to the beneficiary until the testator dies. Or the SNT can be established as a standalone trust, created and funded while the original owner of the assets is still living. "Such a trust can be minimally funded while you are alive," Durston said, "and then added to by yourself, through your will, or by others at your death. This is useful if someone might dispute the trust, because it shows a history of your intention."

The laws on inheritance and gift taxes currently allow a person to make a tax-free gift of \$11,000 per person per year to any number of people. Amounts greater than that must be reported and taxed and will reduce the total amount that may be passed on in an estate at death without paying the inheritance tax. The \$11,000 may not be used to fund an SNT, however, because the law states that the recipient must have access to and control of the gift, and limiting access is the entire point of an SNT. If you want to fund an SNT during your lifetime, you will have to pay the gift tax. However, the IRS allows that \$11,000 tax-free gift to be made to anyone—for example, to a university to pay for a disabled child's education, or to a hospital to cover costs of care—without being subject to the gift tax.

Q. Does the special needs trust itself file annual income tax returns?

A. Yes, the trust must pay tax on any capital gains and income earned by the assets. For this purpose the trust usually has a taxpayer ID number that is separate from the beneficiary's Social Security number.

Q. How do you choose the trustee?

A. Often, in the case of a disabled child, you may want to assign a sibling—although he or she may not have the skills or desire to become involved in trust management and disbursements. A better choice might be a close family friend or a professional fiduciary (i.e., someone who has a high level of responsibility for another person). The Professional Fiduciary Association of California (PFAC) provides training and certification for fiduciaries. Professionals charge \$75 to \$100 per hour for their services and are worth it if fund management does not take much time—although with a mentally disabled client things can take longer than with other disabilities. It can be a relief for family members to have someone else dealing with these issues.

When seeking a professional fiduciary, ask about training, certificates, professional associations and affiliations, and experience with SNTs. If the fund assets are great enough, you can also have them managed by a bank. Mechanics Bank of Richmond is knowledgeable about SNTs.

Often it's a good idea to nominate a trustee and two successors as backup, because age and accidents can change the situation, especially if you have two successive trustees from one family.

You may also want to consider appointing a "trust protector." Here a sibling or other family member, while not being the trustee him- or herself, is given the right to review the trust accounts and, if necessary, fire the trustee and name another, either from a prepared list or by finding a professional.

Q. If a special needs trust can own real estate, could it be a mobile home?

A. Yes. And that's often a good option, because it's less expensive. A special needs trust can own assets of any value, provided the beneficiary cannot sell them. If it's a third-party SNT, then the person setting up the trust can direct how the asset is disposed of when the beneficiary dies.

Q. How does competency affect a person's qualification for these benefits?

A. Under the California Probate Code, a person is presumed to have mental capacity. If this is questioned, you must establish, first, what are the mental functions to be performed? Second, what actual deficits does the person have? Third, do the deficits preclude the fundamental function? With mental illness, this can be a gray area.

But the short answer is, no. To set up an SNT, the beneficiary only needs to be under 65 and have a disability that Social Security recognizes as qualifying. That could be rheumatoid arthritis.

Q. How does an SNT compare with other measures, like a conservatorship?

A. Under a conservatorship, the assets are considered to be available to the beneficiary, which is not allowed under SSI.

Q. How does Social Security monitor all this?

A. When you set up an SNT, you report it to Social Security and send them a copy of the trust document. Thereafter, Social Security has the right to audit the trust and its transactions.

Anytime the beneficiary receives income or in-kind resources that constitute food or shelter, he or she is supposed to report it to the Social Security case worker. If you give the beneficiary groceries, treat him to a meal, give her money, let him live in your home rent free—it all must be reported so that the monthly benefit can be reduced accordingly. So long as disbursements from the SNT are for special needs, not the basics of food and shelter, there is no reduction.

Q. If two divorced parents are responsible for a disabled child, do you set up two SNTs or just one?

A. This depends on the family. There could be one SNT with contributions from both estates, or one SNT from each, depending on how each testator wants to dispose of remaining assets. Duplication is not the worst thing you can have. If one sets up a third-party SNT and the other simply leaves an inheritance, then the inheritance might be put into a first-party SNT, with the trustee directed to spend its assets down so that there is no payback to Social Security.