



What Is a Special Needs Trust?

By Donald G. Olsen, Attorney

A special needs trust is set up for a person with special needs to supplement any benefits that person may receive from needs-based government programs. A properly drafted special needs trust will allow the beneficiary to receive government benefits while still receiving funds from the trust. The assets of the special needs trust will not be counted as an available resource to the beneficiary when determining eligibility for government benefits. The three most commonly used special needs trusts are (1) a first-party special needs trust; (2) a third-party special needs trust; and (3) the pooled special needs trust. Before we briefly discuss each of these three types, it is important to understand how a typical trust works.

How a Trust Works:

A trust is really a relationship between three parties -- a donor, who supplies the funds for the trust; a trustee, who agrees to hold and administer the funds according to the donor's wishes; and a beneficiary or beneficiaries who receive the benefit of the funds. Often, but not always, the donor's wishes are spelled out in a document that gives the trustee instructions about how he/she should use the trust assets. Trusts have been used for estate planning for a long time, and are highly useful tools for ensuring that a donor's property is administered as he/she sees fit. One of the reasons trusts are so popular is that they usually survive the death of the donor, providing a low-cost way to manage the donor's assets for others when the donor is gone.

A *special needs trust* is a trust tailored to a person with special needs and is designed to manage assets for that person's benefit while not compromising access to important government benefits. All three types of special needs trusts name the person with special needs as the beneficiary. One key distinction among these trusts is who is the donor of the assets, i.e. who did the assets belong to before they were put into the trust. A "first-party" special needs trust (sometimes called a "payback trust", or a "D4A trust") holds assets that belong to the person with special needs, such as an inheritance or an accident settlement. A "third-party" special needs trust holds funds belonging to other people who want to help the person with special needs. A "pooled" trust holds funds from many different beneficiaries with special needs.

The reason there are different types of special needs trusts has to do with regulations regarding Supplemental Security Income (SSI) and Medicaid. Generally speaking, in order to qualify for SSI, an applicant or beneficiary can own no more than \$2,000 in his own name. If the person has more than \$2,000 in his own name, (typically because of excess savings, an inheritance or an accident settlement), the government allows him to qualify for SSI so long as he places his



excess assets into a first-party special needs trust. However, the first-party special needs trust must strictly comply with the statutory requirements in order for it to serve its intended purpose.

First-Party Special Needs Trusts:

The first-party special needs trust is specifically authorized by federal statute, namely 42 U.S.C. 1396p(d)(4)(A) (this is why these trusts are sometimes called “D4A” trusts). There are several requirements which must be met in order create this type of trust. The beneficiary must be under the age of 65 and must be disabled under Social Security standards. This trust must be established by the beneficiary's parent or grandparent, or by a court; it cannot be established by the beneficiary, even though it is the beneficiary's assets that are going to be put into the trust. While the beneficiary is living, the funds in the trust must be used for his sole benefit, and when the beneficiary dies, any assets remaining in the trust must first be used to reimburse the government for the cost of medical care provided to the beneficiary under the Medicaid program. The first-party special needs trust must contain a payback clause to reimburse the state for Medicaid benefits paid during the lifetime of the beneficiary. This trust must also include a provision to apportion the payback among different states that had provided benefits, if there is more than one state providing benefits. This is why these trusts are sometimes called “payback” trusts. Once the state(s) has been fully reimbursed by the trust, the remaining assets of the trust (if any) can be distributed to other family members, or charities, or to whomever the trust specifies.

The trust must also specifically state that the trust funds are to be used only to supplement government benefits. Commonly used trust distribution standards, such as the “health and welfare” of the beneficiary, or “health, education, maintenance and support” of the beneficiary must not be used with any type of special needs trust. This language may cause the trust assets to be deemed available to the beneficiary, and will count against the beneficiary when applying the \$2,000 asset limitation for SSI and Medicaid purposes. Unfortunately, this is a rather common and very costly mistake made in poorly drafted special needs trusts.

These trusts are especially useful for beneficiaries who are receiving SSI and who unexpectedly come into large amounts of money from inheritances or injury settlements. The payback trust will allow the beneficiary to retain his government benefits while still being able to use his own funds from the trust to supplement those benefits when necessary.



Third-Party Special Needs Trusts:

The third-party special needs trust is the most common type of special needs trust and is most often used by parents to assist a child with special needs. These trusts can hold most any kind of asset contributed by the parents (or anyone other than the beneficiary), including a house, cash, stocks and bonds, and other types of investments. The third-party trust functions just like a first-party special needs trust in that the assets held in the trust do not affect the beneficiary's eligibility for SSI and Medicaid benefits. The funds can be used throughout the beneficiary's lifetime to pay for the beneficiary's supplemental needs beyond those being covered by the government benefits. The third-party special needs trust has most of the same requirements of the first-party trust, but it differs in one key respect: the third-party trust does not include the "payback" provision found in first-party trusts. This means that when the beneficiary with special needs dies, any funds remaining in the third-party trust can pass to other family members, or to a charity, without having to be used to reimburse the government.

The third-party trust is often designated as the beneficiary of life-insurance, or specifically named as a beneficiary in a parent's will or trust agreement. That way, the parent can be assured that there will be funds to help meet their child's needs after their death, while preserving their child's eligibility for government benefits.

Another common use of the third-party special needs trust is by elderly people who are attempting to qualify for long-term care coverage through Medicaid. Such a person can transfer their assets into a properly drafted third-party special needs trust for the sole benefit of a person with disabilities without incurring a transfer-of-assets penalty. The elder can transfer assets to the trust and immediately qualify for long-term care benefits through Medicaid while also helping meet the needs of the person with disabilities.

Pooled Special Needs Trusts:

A pooled trust is an alternative to the first-party special needs trust. Essentially, a charity or not-for-profit organization sets up these trusts to allow beneficiaries to pool their resources for investment purposes, while still maintaining separate accounts for each beneficiary's needs. When the beneficiary dies, the funds remaining in their trust account will reimburse the government for the beneficiary's care, but a portion will usually also go to the non-profit organization responsible for managing the pooled trust. This helps to ensure that the pooled trust can remain in existence for future beneficiaries.



One common use of the pooled trust is where the funds going to the person with disabilities via inheritance or settlement are not substantial enough to justify the creation of a separate first-party trust, but will still cause loss of government benefits if something is not done. The fees for joining and remaining in the pooled trust are typically much less than the costs of a separate trust.

Conclusion:

If the trust is properly drafted, funds can be set aside to meet the future needs of a person with disabilities without causing the loss of important government benefits, such as SSI and Medicaid. However, there are many specific legal requirements which must be met, and many pitfalls to be avoided. And of course, every person with special needs is different, and every situation is unique. The proper way to determine which special needs trust is right for a family is to work with a qualified professional to discuss the family's particular needs.

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