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Special Needs Trust Overview

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SPECIAL NEEDS TRUSTS OVERVIEW*

I. INTRODUCTION: THE FOCUS OF THIS PAPER.

Since passage of the Omnibus Budget Reconciliation Act of 1993,¹ the use of Special Needs Trusts (also known as Supplemental Needs Trusts or “SNT”) has grown to such proportions that just about every practitioner has heard of the trust but there is still much confusion about the terms and reasoning behind a SNT. The intent of this author is to define a SNT, set out when it is generally used, list some strategies for creating the trust and a brief discussion of the tax implications of the trust.²

II. THE SPECIAL NEEDS TRUST.

A. DEFINITION. A special needs trust is a broad term encompassing self-settled and third party created trusts. It is a trust created for an individual with the intent of allowing distributions from the trust to the beneficiary while the beneficiary has the option of maintaining eligibility for governmental “needs based” benefits.

The operative words describing this trust are “supplemental needs” thereby distinguishing this trust from a “support” or other type of trust. Other words used to describe the supplemental needs trust are instructional such as a limitation that trust distributions should “supplement and not supplant governmental benefits.” SNTs may have very strict distributions restrictions prohibiting certain distributions. More broadly, SNTs may give the trustee full discretion to make distributions even to the extent of causing the beneficiary to forfeit some but not all governmental benefits.³

B. BRIEF HISTORY OF THE SNT. Practitioners have always taken legal steps to draft trusts so that the beneficiary does not forfeit valuable governmental need based benefits. The Medicaid program has long been one of the most regulated of the “need based” programs and therefore, the SNT sprang from Title XIX of the Social Security Act.

1. Prior to June 1, 1986. The Medicaid program was originally established in 1965. It was designated Title XIX of the Social Security Act, found at 42 U.S.C. §1396 et seq. The purpose of the Act was “to provide medical assistance to persons whose income and resources are insufficient to meet the costs of necessary care and services.”⁴ In the early days, a person receiving or anticipating the use of governmental benefits would attempt to meet the low asset requirement by transferring assets into a trust for him/herself. Few of these trusts successfully protected benefits, as common law and public policy prohibited a person from placing his assets in trust to the detriment of creditors.⁵

However, some case law held that if the beneficiary never had possession of funds that funded a trust, then the trust would not be considered grantor created.⁶ Therefore, petitioners in a personal injury suit would have the court or guardian apply any recovery directly into a trust so that the beneficiary never actually had possession of those funds.

2. June 1, 1986 to August 10, 1993: Then in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA '85)⁷, Congress defined a Medicaid Qualifying Trust ("MQT"), codifying common law and public policy prohibiting an individual from using a self-settled trust as a means to divest assets and qualify or maintain eligibility for benefits.⁸ In this statute, a trust created by an individual or the individual's spouse for the individual's benefit would be considered a MQT to the extent distributions could be made from the trust for the benefit of the beneficiary⁹. The statute provided that if the trustee had the discretion to make a distribution, then, whether or not such a distribution was made, the trust asset was accessible to the beneficiary.¹⁰ Thus, beginning on June 1, 1986, if an individual was found to have funded a "medicaid qualifying trust" the individual would generally be INELIGIBLE for Medicaid benefits, since the trust would be considered an asset. If however, the trustee had limited or no discretion to make distributions, only those distributions that could be made by the trustee would be considered.¹¹ Additionally, if a guardian or a court funded a trust with a personal injury recovery, some courts would not consider such trusts as created by an "individual" as defined by the statute and thus the trust would not be an MQT.¹²

3. After August 10, 1993. In the Omnibus Budget Reconciliation Act of 1993 ("OBRA '93"), Congress redefined the treatment of self-settled trusts to specifically define a self-settled trust as one created by an individual, a spouse, a court or a guardian or any device that had the same effect as a trust¹³ which is funded with the beneficiary's money.¹⁴ Congress also carved out three exceptions to the self-settled trust rule that are referred to as (1) a Supplemental Needs Trust,¹⁵ (2) Miller or Qualifying Income Trust,¹⁶ and (3) Pooled Trust.¹⁷

4. Amendment to Title XVI of the Social Security Act. The following is an excerpt from a Social Security transmittal dated May 26, 2002, addressing the significant changes to laws governing SSI and trusts:

" On 12/14/99 the President signed into law the Foster Care Independence Act of 1999 (P.L. 106-169). Section 205 of this law provides generally, that trusts established with the assets of an individual (or spouse) will be considered a resource for SSI eligibility purposes. It also addresses when earnings of or additions to trusts will be considered income. This provision is effective for trusts established on or after 01/01/00. ... Specifically, this transmittal provides instructions for developing exceptions to SSA's new trust policy for: trusts established under section 1917(d)(4)(A) of the Social Security Act (SSACT) (commonly called supplemental or special needs trusts); and pooled trusts established under section 1917(d)(4)(C) of the Social Security Act. We refer to the exceptions discussed in this message as Medicaid trust exceptions." ¹⁸

III. GOVERNMENTAL BENEFITS THAT ARE SUSTAINABLE WITH A SPECIAL NEEDS TRUST. In order to properly draft a SNT that will maximize the client’s government benefits, counsel must understand the criteria for those governmental programs that one is attempting to protect. Some governmental programs are “need based,” such as Medicaid and medicaid waiver program, Community Based Alternative (“CBA”), Supplemental Security Income (“SSI”), and certain programs offered through other governmental agencies. These “need based” programs generally base eligibility on a finding of disability, low income and low assets. Other programs such as Social Security Disability Insurance (“SSDI”) consider only earned income for eligibility considerations.¹⁹ The following three programs provide the vast majority of need based benefits to Texas residents.

A. MEDICAID ASSISTANCE PROGRAM.

1. Defining the program. Medicaid Assistance Program and medicaid assistance waiver programs are governmental programs that can provide housing and medical care for those persons who meet certain physical and financial guidelines. When an individual has few resources (assets), a small monthly income and a medical need, the individual may be eligible for no-cost health care, and housing assistance in a nursing home. Medicaid should not be confused with Medicare Part A and Part B. Medicare does not pay for long term nursing home care benefits.

Author’s Comment: Medicare Part A pays for up to 100 days of nursing home care provided the care is for skilled services. 42 U.S.C. §1395x. The patient is entitled to the skilled nursing or skilled rehabilitative benefits in a skilled nursing facility (SNF) following a 3 day stay in the hospital. 42 C.F.R. §409.31 *et seq.* Part A will pay the costs of the first 20 days in the SNF provided they are pursuant to a physician’s order, the patient requires professional or technical personnel, and the care is under the supervision of such personnel and the patient must require rehabilitative and/or skilled services on a daily basis. *Id.* Beginning day 21 through 100, the patient must pay \$141.50 per day (for 2011).

If an individual needs long term care and meets certain criteria, the Medicaid program may provide the necessary funding for care.²⁰

2. Enabling Statutes. The Omnibus Budget Reconciliation Act of 1993 (“OBRA ’93”) set out the general guidelines for current Medicaid eligibility.²¹ In Texas, the Health and Human Services Commission (sometimes referred to as the “HHSC”) administers the Medicaid Assistance Program. The Texas eligibility requirements and regulations for administering the program are found in Chapter 32 of the Texas Human Resources Code, Title 1, Part 15, Chapter 358 of the Texas Administrative Code and in the Texas Medicaid Eligibility Handbook.²²

3. Eligibility for Medicaid Assistance Program. In order to qualify for the Medicaid Assistance Program, one must meet certain criteria.

a. Resources. If the individual has accumulated more than a limited amount of resources, then the individual will not be eligible for Medicaid. Resources are generally defined as liquid assets such as cash, real or personal property or assets owned by the applicant or the spouse that could be converted to cash.²³

(1) Countable Resources for a Single Individual. To qualify for Medicaid, an individual's countable resources cannot exceed \$2,000.00.²⁴

(2) Countable Resources for a Married Couple. If both spouses are applying for long term care nursing home benefits, then their combined resources generally cannot exceed \$3,000.00.²⁵

If only one spouse is applying for Medicaid benefits, Congress has provided a means of protecting some resources for the spouse not applying for benefits. In the Medicare Catastrophic Coverage Act of 1988²⁶, Congress provided that all non-exempt resources of both spouses will be counted as resources for eligibility purposes whether the property is classified as community or separate.²⁷ One-half of the couple's resources will be set aside for the spouse not applying for Medicaid benefits, with a minimum set aside amount of \$21,912 (for 2011) and a maximum of \$109,560 (for 2011).

For example, if the combined community and separate property of a couple equaled \$13,000.00, then their total resources would be set aside for the non-applicant spouse. If their combined community and separate property equaled \$100,000, then one-half, or \$50,000, would be set aside for the non-applicant spouse and the couple would generally have to "spend down" \$48,000 (the applicant keeping \$2,000) to bring the applicant within the eligibility guidelines. While the general rule is to protect one-half or \$109,560 of the family's assets for the community spouse, under certain circumstances, all or part of the Applicant's \$48,000 could be transferred to the at-home spouse. For example, assume Husband's available income is \$1200.00 per month and Wife's gross income is \$300.00 and their combined countable resources equal \$100,000. The HHSC regulations state that the at-home spouse can retain a minimum monthly maintenance needs allowance ("MMMNA") of \$2,739 for the year 2011. But in this example their combined income from pensions is only \$1,500. Wife would argue that she needs to invest their savings in order to generate an income for herself to bring her up to the MMMNA of \$2,739. HHSC will accept current one-year Certificate of Deposit rates to determine the income that Wife could generate from the \$98,000 (recall that the Applicant gets to keep \$2,000). Assume the current interest rate for a one-year CD is 3%. To calculate the income that \$98,000 would generate one can follow the following formula:

MMMNA = \$2,739 - \$1,500 = \$1,239 / month shortfall
\$98,000 X .03 = \$2,940 annual income ÷ 12 months = \$245.00 per month generated
by savings which is less than the monthly shortfall.

From the calculation, the countable assets must be protected for the community spouse in order to generate income to attempt to bring the Wife up to the minimum monthly maintenance needs allowance of \$2,739 per month. Thus, the caseworker would then ask the Wife to sign a Form 1275 with the result that the \$98,000 would be protected for Wife.

Comment: The above calculation is referred to as the “income first” rule which means that the applicant’s income must be diverted to the community spouse in order to provide for the MMMNA before resources will be protected. For many years, Texas has been a “resource first” state, allowing the community spouse to protect assets before accepting any of the applicant’s income. However, on August 6, 2004, virtually the last rule making act of the Texas Department of Human Services Board was to vote to adopt the “income first” rule which will be effective for all persons entering a nursing facility on or after September 1, 2004. Moreover, the Deficit Reduction Act of 2005 (Public Law 109-171) requires the “income-first” methodology for “snapshot dates” of February 8, 2006 and later.

Finally, if their combined community and separate property equaled \$200,000, then \$109,560 would generally be set aside for the non-applicant spouse and, as above, the couple would theoretically have to "spend down" \$88,440 (setting aside \$2000 for the applicant) to bring the applicant within eligibility requirements with regard to resources.

(3) Excluded Resources. Certain resources are excluded from being considered countable resources:

(a) The principal residence of the applicant is generally excluded from consideration as a countable resource. Even if a single applicant lives in a nursing home, if the applicant *intends* to return to his home, then the property remains exempt.²⁸

(b) A burial plot held for the applicant or the applicant's family will not be counted as a resource.²⁹

(c) Term or burial insurance is not a resource if it has no cash value.³⁰

(d) Identifiable burial funds in the amount of \$1,500³¹ or a prepaid irrevocable burial contract regardless of the value³² is excluded from countable resources. The \$1,500 burial funds exclusion is offset by the face value of excluded life insurance policies and the value of any irrevocable burial arrangements.

(e) One automobile. A second automobile may be exempt if there is a second person in the household and the second vehicle is required for work or is modified for operation by, or the transportation of, a handicapped person.³³

at less than \$5,000 are exempt.³⁴ (f) Household goods and personal effects that are valued

(g) Life insurance policies owned by the applicant with a face value of \$1,500 or less per insured are exempt.³⁵

(h) Livestock that are held for business purposes or for consumption are not counted.³⁶

(i) Business property essential for self-support is exempt but the income generated will be countable.³⁷

(j) Non-business property essential for self-support is exempt at a value up to \$6,000 as long as the owner receives at least 6% net annual return on the investment. Again, the income generated will be included in the applicant's total income.³⁸

(4) Transfer of resource rules. A nursing home or Community Based Alternative (CBA) applicant may wish to preserve his resources by transferring some or all of his nonexempt resources to his child/children, either outright or in trust, with the understanding that the child/children would provide for the applicant's special needs.

(a) Effect of Disqualifying Transfer. If a nursing home or CBA applicant makes a transfer of resources for less than fair market value, for the purpose of qualifying for Medicaid, the applicant will be ineligible for Medicaid benefits for a calculated period of time.³⁹ The Health and Human Services Commission has determined that the average private pay cost for nursing home care in Texas is \$130.88 per day. To determine the number of days of INELIGIBILITY for any transfer for less than fair market value, the Health and Human Services Commission will divide the amount transferred by \$130.88 and round down to the lower day. For example, if an applicant gifted \$10,000 to an individual, the applicant would be ineligible for Medicaid for 76 days.

i. OBRA '93. Under OBRA '93, the Health and Human Services Commission can "look back" was 36 months to determine if an individual made an outright transfer for less than fair market value.⁴⁰ Additionally, the "look back" period for a transfer into a trust was generally 60 months.⁴¹ However, under the Deficit Reduction Act of 2005, the penalty "look back" period for all transfers is 60 months (see below).

Under OBRA '93, "if a transfer is made, the penalty period runs from the first day of the month in which the asset was transferred provided that the date does not occur during an existing penalty period."⁴² For an institutionalized individual the look-back period is 36/60 months prior to the baseline date. "The baseline date is the first date as of which the individual was (a) institutionalized; AND (b) applied for medical assistance under the state plan."⁴³ For a non-institutionalized person, "the look-back date is 36/60 months prior to the baseline date, which is the

date the individual (a) applies for medical assistance under the State plan; or, if later, (b) the date on which the individual disposes of assets for less than fair market value.⁴⁴

Finally, under OBRA '93, if a disqualifying transfer has been made, the applicant can appeal a denial of coverage, arguing that the denial of Medicaid benefits would work an undue hardship. "Undue hardship exists when application of the transfer of assets provisions would deprive the individual of medical care such that his/her health or his/her life would be endangered. Undue hardship also exists when application of the transfer of assets provisions would deprive the individual of food or shelter, or other necessities of life. Undue hardship does not exist when application of the transfer of assets provisions merely causes the individual inconvenience or when such application might restrict his or her lifestyle but would not put him/her at risk of serious deprivation."⁴⁵

ii. The DRA of 2005. The Deficit Reduction Act of 2005 ("DRA 2005"), effective February 8, 2006, changes both the length of the look-back period and the date that the penalty period begins. For Medicaid applications for nursing home care filed on or after October 1, 2006, if the transfer transaction occurred on or after February 8, 2006, the following rules apply:

Look-Back period - The look-back period is 60 month for all transfers. [*DRA 2005, §6011(a)*]

When the Penalty Period Begins - The penalty period begins on the later of the following dates:

- ° The first day of the month in which the transfer occurred; or
- ° The first day of the month in which the individual is eligible for Medicaid and would be receiving institutional care but for the transfer. [*HHSC, LTC Medicaid Bulletin Number 07-01, "Deficit Reduction Act of 2005 - Transfer of Assets," September 25, 2006, p.7*]

Undue Hardship - With regard to undue hardship waivers under the DRA 2005, the nursing home may, with the individual's (or his personal representative's) permission, file an application on the individual's behalf for a waiver of the transfer penalty based on undue hardship. The nursing home may present on the individual's behalf and, with the written consent of the individual (or his/her personal representative), represent the individual in the appeal process. [*DRA 2005, §6011(e)(1)*] Moreover, while an application for an undue hardship waiver is pending, Medicaid may pay bed-hold charges to the nursing home for up to 30 days on the individual's behalf, if certain criteria to be specified by the Secretary of the U.S. Department Health and Human Services are met. [*DRA 2005, §6011(e)(2)*]

b. Income. Under Texas Medicaid law, an individual must also have a limited monthly income in order to qualify for the Medicaid Assistance Program.

(1) Texas Cap. An applicant's gross income generally cannot exceed \$2,022 per month for 2011. If both spouses are applying for Medicaid, their combined income cannot exceed \$4,044 per month for 2011. The non-applicant spouse's income is not considered for the purposes of the applicant's eligibility.⁴⁶ Further, the Federal Spousal Impoverishment Act sets out what is referred to as "the name on the check" rule⁴⁷ which means that income is attributed to the spouse whose name is on the check regardless of community or separate property characterization. For example, if applicant husband received a pension in the gross amount of \$1,600.00 per month and the husband and wife were holders of a Note receiving \$1,000.00 per month, the husband-applicant would be credited with \$2,100.00 per month of income which would disqualify him for Medicaid long term nursing home care benefits.⁴⁸ However, if the debtor made the Note payment check payable to Wife, then Husband would have only \$1,600.00 per month of income which is under the Texas income cap.

(2) Qualifying Income Trust ("Miller Trust"). Assume that the applicant meets all of the medicaid eligibility criteria except the individual's income exceeds the Texas income cap (\$2,022 for 2011). However, his income is substantially less than the \$3,500.00 to \$5,500.00 per month usually required for long term nursing home care. If the Applicant is single and ineligible for Medicaid benefits because of excess income, then someone (usually a family member) would have to pay the difference between his income and the cost of nursing home care (although there is no legal requirement for this payment). This places a tremendous burden on children who have their own obligations including possible education costs for their own children. If the Applicant is married, his nursing home costs may take all of the combined incomes of both spouses just to pay for private pay nursing home expenses. OBRA '93 provided the solution to this "income cap" problem.

An individual can create a trust and then transfer his income to the trust without penalty. He would not own the income and therefore would fall below the income cap. This trust is known as a "Qualifying Income Trust," "QIT" and is often referred to as a "Miller" Trust which gets its name from a Colorado case⁴⁹ that was codified in 42 U.S.C. 1396p(d)(4)(B). The trust must be irrevocable and the State must be reimbursed from any remaining assets in the trust after the beneficiary/applicant dies.⁵⁰ **A "MILLER TRUST" IS NOT A DEVICE TO PROTECT ASSETSOR RESOURCES. IT IS ONLY A DEVICE FOR INCOME AND IS USED TO OVERCOME THE INCOME CAP ISSUE.**

(a) Married Applicant. The "Miller" Trust is especially important for the community spouse because it allows her to remain independent while she is confident that her husband is receiving proper care in the nursing home.

Recall that the community spouse's income is not considered for determination of Medicaid eligibility of her applicant spouse. Therefore she can keep all of the income that she receives in her name. Additionally, if her husband qualifies for Medicaid benefits, she will be allowed to keep up to \$2,739 (as of 2011) of their combined income.⁵¹ For example, husband receives \$2,100 per month in retirement and social security income, while wife receives \$300 per month. H's income is placed

in a "Miller" Trust and assuming that H otherwise qualifies for Medicaid long term nursing home care assistance, W will get all but a \$60.00 (allowance paid to H) of their combined income of \$2,400.00 and H's nursing home and medical costs will be paid for by Medicaid.

With a Miller Trust in place, the applicant's income placed in the trust will be paid as follows: (1) the institutionalized spouse will receive a monthly allowance of \$60 and guardian fees, if any, will be paid⁵²; (2) the community spouse will receive enough money to raise her income to \$2,739 (as of 2011); (3) if there are any dependents, the dependent allowance will be deducted; (4) if there are any "incurred medical expenses" such as allowable insurance premiums and costs of medical care not covered by Medicaid (which include guardian's fees⁵³), those amounts will be paid; (5) "applied income" will be paid to the nursing home.⁵⁴

(b) Single Applicant. An unmarried Applicant may also utilize a Miller Trust to overcome the income cap. With a Miller Trust in place, the single applicant's income transferred to the trust will be paid as follows: (1) the institutionalized person will receive a monthly allowance of \$60 and guardian fees, if any, will be paid⁵⁶; (2) if there are any "incurred medical expenses" such as allowable insurance premiums and costs of medical care not covered by Medicaid, those amounts will be paid; (3) "applied income"⁵⁷ will be paid to the nursing home⁵⁸; and (4) any remaining income can be used by the beneficiary for his or her own needs but, practically speaking, seldom will there be any funds left after payment of the applied income.

(c) Creating a Qualifying Income ("Miller") Trust. A Qualifying Income Trust is a "self-settled" trust; therefore, the Applicant should be the person signing the trust as Grantor. However, often the Grantor is incapacitated and does not have the capacity to sign the trust.

The alternative, of course, is to have the agent, under a Durable Power of Attorney, sign on the Grantor's behalf. Unfortunately, all too often, there is no durable power of attorney. However, if you look closely at the statute, there is nothing in the statute that requires the person funding the trust with his income to be the original creator of the trust. [Region 8 Health and Human Services Commission (central Texas) takes the position that it does not matter who signs the trust as long as that person has some means of diverting the beneficiary's income into the trust. Generally, that would be someone who is a signer on the beneficiary's bank account such as a spouse or child].

c. Other Eligibility Requirements. An applicant for the Medicaid Assistance Program must be a U.S. citizen or a "qualified alien" meeting certain requirements⁵⁹ and must be a Texas resident.⁶⁰ Under the DRA of 2005, a Medicaid applicant declaring to be a U.S. citizen must provide evidence of citizenship, such as a U.S. passport, a Certificate of Naturalization (N-550 or -570), a Certificate of U.S. Citizenship (-560 or -561), or other documentation. [*HHSC, LTC Medicaid Bulletin Number 06-11, "Revised Citizenship Documentation Requirements for*

Medicaid,” August 21, 2006, p.1] If the applicant is applying for nursing home care assistance, then he/she must be over 65, disabled or blind.⁶¹ Finally, if the applicant is applying for nursing home care or a facility care waiver program, the applicant must have a "medical necessity" for the care.⁶²

4. Trusts and Medicaid Eligibility. In planning for Medicaid eligibility, clients often ask if they can put their resources into a trust and then qualify for Medicaid long term nursing home care benefits. Generally speaking an applicant may not place his own money in a trust for himself and then immediately qualify for Medicaid benefits. For example, if an individual creates a “living trust” that is revocable, HHSC considers the assets in the trust as available assets since the trust can be terminated by the grantor.⁶³ In the alternative, if the Grantor transfers his/her assets into an irrevocable trust, the transfer is subject to the look-back period and transfer penalties.⁶⁴

Additionally, with the irrevocable trust if the trustee has the discretion to make distributions from income for the benefit of the grantor, then that amount of income that the trustee COULD distribute will be attributed to the grantor.⁶⁵ If the trustee has the discretion to make distributions from principal for the benefit of the grantor, then that amount of principal that the trustee COULD distribute will be attributed to the grantor.⁶⁶

However, there are exceptions to the rule that the trust is a countable, or in some way, a disqualifying resource. As we have discussed, an applicant may generally put income in a Qualifying Income Trust (the "Miller" Trust) and become eligible for Medicaid benefits, provided the applicant meets all other eligibility criteria. The following are the Self-settled trust exceptions created by Congress.

a. OBRA '93 Self-settled Trust Exceptions. If your client is under the age of 65, then the client may find it advantageous to have assets placed in a Supplemental Needs Trust⁶⁷ created pursuant to OBRA 93 which allows the creation of such trusts. OBRA '93 carved out three exceptions to the inclusion of grantor trust assets in the determination of an applicant's eligibility. The exceptions are found at 42 U.S.C. § 1396p(d)(4)(A), (B) and (C) and are often referred to by their subsection letter.⁶⁸

(1) "A" Trust. This trust is especially designed for a disabled person⁶⁹ under the age of 65. Assuming the disabled person meets the income cap requirement, a Supplemental needs trust can be funded with the disabled person's assets and the person will automatically qualify for the Medicaid Assistance program provided that (i) the trust is created by the applicant's parent, grandparent, legal guardian or the court and (ii) upon the death of the beneficiary/applicant, the State will receive any remaining funds in the trust up to a total of all of the State's Medicaid payments made on behalf of the beneficiary/applicant.⁷⁰

By the terms of this statute, no one 65 years or older can utilize this exception. Therefore, if a 65+ year old person who is receiving Medicaid long term nursing home care benefits obtains a personal injury recovery or inherits property, that person cannot put the funds into a (d)(4)(A) trust⁷¹ and remain eligible for Medicaid benefits.

(2) "B" Trust, Qualified Income Trust or "Miller Trust". As previously discussed in Section III.A.3.b.2, *supra*, an Applicant for Medicaid long term nursing home care benefits can utilize this self-settled trust exception.

(3) "C" Trust. Finally, the third exception to the self-settled trust rules is the creation of a "pooled supplemental needs trust." This trust is a supplemental needs trust created by the Grantor, the grantor's parent, grandparent, court or guardian for a disabled person.⁷² The trust must be managed by a non-profit association. This trust must also be drafted so that, at the beneficiary's death, the State will be reimbursed, from the remaining assets in the trust, for all expenditures made on behalf of the beneficiary.⁷³ The Arc of Texas in Austin, Texas, is presently administering this trust as its "Master Pooled Trust."⁷⁴

Effective February 3, 1998, the Texas Medicaid program changed its position on these trusts and eliminated the age 65 limitation so that a person of any age who meets the Social Security Administration disability criteria may utilize this trust. According to the February 3, 1998 Texas Department of Human Services Memorandum, the trust is managed ... "by a non-profit association [The Arc of Texas]. A sub-account is maintained for each beneficiary, but for investment/management purposes the accounts are pooled."

However, the Texas Medicaid program subsequently reversed its February 3, 1998 position and now assesses a period of INELIGIBILITY against a person age 65 and older who transfers funds to a sub-account with The Arc of Texas Master Pooled Trust. The HHSC position is based on the Center for Medicare and Medicaid Services' rule that limits the transfer of asset disqualification exception to only those persons under age 65.⁷⁵ With this rule change, a person age 65 or older who is presently eligible for Medicaid long term nursing care benefits (or Community Based Alternatives) is essentially prevented from funding a trust with a lump sum of funds from a personal injury award, inheritance or sale of an exempt asset because of transfer penalties.

b. Third Party Trusts. Can a trust beneficiary qualify for or continue to receive Medicaid benefits? Other than the three Self-settled Trust exceptions under 42 U.S.C. §1396p(d)(4) discussed above, a person generally cannot put his own assets into a trust for his benefit and then qualify for Medicaid.⁷⁶ However, trusts created by someone other than the applicant and funded with funds that do not belong to the applicant may not be considered a countable resource.⁷⁷ Articles IV, V & VI, *supra*, contain an extensive discussion of self-settled and third party trusts.

5. Estate Recovery. In 1993, in the Omnibus Budget Reconciliation Act, Congress mandated that states recover certain long-term care ("LTC") expenditures made for a Medicaid recipient over the age of 55.⁷⁸ The Texas Legislature resisted implementation of estate recovery for ten years. However, on June 10, 2003, Governor Perry signed House Bill 2292, allowing the State of Texas to recover payments made on behalf of a person who receives Medicaid benefits. The law effecting estate recovery was brief:

“SECTION 2.17. Subchapter B, Chapter 531, Government Code, is amended by adding Section 531.077 to read as follows: Sec. 531.077. RECOVERY OF MEDICAL ASSISTANCE. (a) The commissioner shall ensure that the state Medicaid program implements 42 U.S.C. Section 1396p(b)(1). (b) The Medicaid account is an account in the general revenue fund. Any funds recovered by implementing 42 U.S.C. Section 1396p(b)(1) shall be deposited in the Medicaid account. Money in the account may be appropriated only to fund long-term care, including community-based care and facility-based care.

The federal law, 42 U.S.C. Section 1396p(b)(1), requires a state to recover expenditures from the estate of a deceased person who received Medicaid benefits--thus the name “estate recovery.” The federal statute does not set out the rules for estate recovery--leaving the rule making to the Commissioner of the Texas Health and Human Services Commission (“HHSC”) heading up the State Medicaid program. Federal law does set out basic requirements along with guidelines and options in the law and in Section 3810 of the Federal State Medicaid Manual. After studying the rules implemented in other states, HHSC published the proposed framework of the rules on January 26, 2004 for discussion purposes and scheduled six (6) regional forums to take public comment on the proposed framework. On April 30, 2004, the Texas Health and Human Services Commission (“HHSC”) published its proposed Estate Recovery rules ‘(sometimes referred to as “ERR”). The rules had to be approved by the Centers for Medicare and Medicaid Services (“CMS”) prior to being effective. After much discussion with CMS, revisions to the rules were made and those revisions were published in the December 3, 2004 *Texas Register*. A number of organizations including the Texas Chapter of the National Academy of Elder Law Attorneys submitted comments on the revised rules. On February 18, 2005, the agency’s response to the comments and those rules that were changed pursuant to the comments were published in the *Texas Register*. Since only those rules that were revised were published in the February 18th issue of the *Texas Register*, the author has merged the unchanged rules from the December 3rd issue along with the final, revised rules from the February 18th issue, a copy of which is attached as Appendix IV. The following is a short summary of the rules and a few concerns.

a. Who is subject to estate recovery?

Federal Law: The federal law requires recovery “from the estate of an individual who was age 55 or older when that person received medical assistance.... up to the total amount spent by Medicaid on the person’s behalf, for spending on nursing facility services, ..., home and community based services,... and related hospital and prescription drug services.” State Medicaid Manual §3810.

Texas Rules: Estate recovery will only effect those persons who are age 55 or over, are in a nursing home, intermediate care facility for the mentally retarded (referred to as “ICF-MR”) or are

receiving Community Attendant Services (1929(b) and home and community-based services and who apply for Medicaid on or after the effective date of the rules.⁷⁹ According to the rules, there will be no estate recovery from the estate of a person who initially applied for Medicaid prior to the effective date of the rules.

b. What is the effective date of the ERR? The rules will be effective March 1, 2005. 1 T.A.C. §373.105(5).

c. What is the definition of an “estate” that is subject to a claim for recovery? **Federal Law:** The Health Care Financing Administration (“HCFA”), now known as the Center for Medicare and Medicaid Services promulgated and maintains the State Medicaid Manual which is a plain English departmental interpretation and suggested implementation of the federal Medicaid program. Section 3810 of the State Medicaid Manual notes that the federal law allows the state to create its own definition of “estate” as follows:

“Probate Definition.--At a minimum, you must include all real and personal property and other assets included within the individual’s estate as provided in your State probate law.”

“Optional Definition.--In addition to property and assets under the probate definition, you may include any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest). This includes assets conveyed to a survivor, heir, or assignee of the deceased through joint tenancy, tenancy in common survivorship, life estate, living trust, or other arrangement.”

Texas Rules: The original published proposed framework stated that exemptions to the definition as follows:

“An estate would NOT include:

- insurance policy proceeds;
- retirement accounts such as IRAs;
- pension plans;
- financial institution accounts-bank P.O.D. (paid on death) accounts or joint accounts, or credit union accounts;
- mutual funds; or
- deferred compensation plans

The HHSC rules defined “estate” according to the Texas Probate Code definition found in Probate Code §3. 1 T.A.C. §373.105. Essentially, the property included in the definition of “estate” is any property that the nursing home resident owned on the date the nursing home resident died. A nursing home resident who is receiving Medicaid benefits might own the following assets, known as exempt assets for eligibility purposes, on the date of death:

- homestead;
- personal property including family heirlooms, antiques and other sentimental items;
- automobile;
- family burial plots;
- family ranch or farm that was considered a business necessary for the person’s self-support;
- farm or ranch equipment;
- poultry or cattle;
- small oil or gas interest that was considered non-business property necessary for self-support;
- no more than \$2,000.00 in cash assets.

d. What expenditures will the State recover? All expenditures arising from payments for nursing home, ICF-MR, home and community services and the related costs of prescription drug services and hospital. 1 T.A.C. §373.103

e. How will the State recover? First and foremost, Estate Recovery is not a lien statute. The law found in House Bill 2292 and the rules make the state of Texas a creditor to the decedent’s estate. See paragraph “F” supra. The proposed rules make the State of Texas a Probate Code §322 Class 7 creditor. 1 T.A.C. §373.201.

Texas Probate Code §322 classifies claims against a decedent’s estate in a priority from Class 1 to Class 8 claims. Class 7 claims are “claims for repayment of medical assistance payments made by the state under [the Medicaid program] to or for the benefit of the decedent.” Therefore, payment of up to \$1500 for funeral and last illness, expenses of administration (which include attorneys fees), secured claims, child support claims, claims for taxes, penalties and interest all have priority over payment of the Medicaid costs. The Estate Recovery rules, as written, require that as soon as the State finds out that a nursing home resident is deceased, the State will send a Notice of Intent to File a Claim from a nursing home resident’s estate. The State has up to 30 days from being notified of the individual’s death to send the Notice of Intent to File a Claim.

Concern: According to the rules, as written, the State can give the notice to an executor or administrator if an estate administration is opened and the State knows who the executor or administrator is. However, it may take some time to open an estate administration, so instead of waiting for an estate administration to be filed and opened, the State may give notice to a guardian, a person who acted under a power of attorney or even the person who communicated with the caseworker while the nursing home resident was alive. 1 T.A.C. §373.307. The problem is these persons have no authority to act for other heirs.

f. Will the State place a lien on the homestead to secure its right to recover? The Texas Legislature requires the Commissioner to implement 42 U.S.C. §1396p(b)(1). This subsection of the statute requires a State to recover expenditures from an estate, similar to a

creditor. The federal statute allowing the State to place a lien on a homestead is found in 42 U.S.C. §1396p(a). Additionally, the Legislature did not repeal the Constitutional homestead protections or Texas Probate Code §§270-271 that exempt the homestead from creditors claims if there is a surviving spouse, minor child or unmarried adult child. The HHSC representatives recognize that the 2003 legislation did not grant the right to place a lien on the Medicaid recipient's property to secure the payment of the medicaid expenditures. **THIS IS NOT A LIEN STATUTE.**

g. Can a family try to pay off the estate recovery debt in order to preserve the homestead, family heirlooms and antiques, and other estate assets? Yes, according to the **Texas Rules**, the family can negotiate a payment installment plan but interest on the unpaid portion of the claim will be calculated according to a law in the Texas Government Code. That law that sets interest on a debt states that the interest rate will be 1% + the prime rate as published in the Wall Street Journal on the first day of July of the preceding fiscal year that does not fall on a Saturday or Sunday. The Wall Street Journal prime rate has been about 4% for the past year. Therefore, the interest rate applied to an installment plan would be approximately 5%. 1 T.A.C. §373.219

Concern: This rate changes yearly. The question arises: would the interest rate on the unpaid balance also fluctuate?

h. Are there any exemptions to estate recovery?

Federal Rules: The federal law sets out exemptions to estate recovery:

- The State cannot recover while there is a surviving spouse.
- The State cannot recover while there is a child under the age of 21 or is blind or disabled;

Texas Rules: There will be no estate recovery if the Medicaid beneficiary leaves:

- a surviving spouse.
- a child under the age of 21 or a child of any age who is blind or disabled;
- an unmarried adult child residing continuously in the decedent's homestead for at least one year prior to the time of the Medicaid recipient's death. 1 T.A.C. §373.207

i. If there is no exemption from Estate Recovery, then are there any other considerations? Yes. Certain defined persons can claim that estate recovery would be an undue hardship and ask the State to waive recovery.

Federal law: Estate Recovery can be waived if Estate Recovery would cause an undue hardship or would not be cost effective. The State has the discretion to define "undue hardship." The State Medicaid Manual urges but does not require States to "provide for special consideration of cases in which the estate subject to recovery is:

- the sole income-producing asset of survivors (where such income is limited), such as a family farm or other family business;
- a homestead of modest value; or
- other compelling circumstances.”

The Medicaid Manual goes on to state that “in considering your criteria [in defining undue hardship], you may conclude that an undue hardship does not exist if the individual created the hardship by resorting to estate planning methods under which the individual illegally divested assets in order to avoid estate recovery.”

Texas Rules: The Texas Rules set out six categories in which to claim an undue hardship, found in 1 T.A.C. §373.209(c) and (d):

1. “The estate property subject to recovery has been the site of the operation of a family business, farm or ranch at that location for at least 12 months prior to the death of the decedent; is the primary income producing asset of heirs and legatees, and produces 50 percent or more of their livelihood; and recovery by the State would affect the property and result in the heirs or legatees losing their primary source of income.” 1 T.A.C. §373.209(c)(1)

Concern: Now heirs or legatees will have to produce their own financial records in order to prove the percentage of livelihood or primary source of income.

Concern: A family farm or ranch is generally not a cash producing asset. It provides food and shelter while , often, one of the household members will work at a second job to provide working cash. According to *USDA/ERS Agricultural Income and Finance Outlook* statistics citing in the *Texas Agriculture*, a publication by the Texas Farm Bureau, **68 percent of Texas farm household earnings are from off-farm sources**. By requiring the farm or ranch to produce 50 percent of the heirs or legatees livelihood in order to obtain the waiver from estate recovery, the rule essentially negates the undue hardship waiver and virtually all family farms or ranches would be subject to estate recovery. In fact, the rule would benefit large corporate farms while penalizing the small family farm.

2. “Heirs and legatees would become eligible for public and/or medical assistance if a recovery claim were made.” 1 T.A.C. §373.209(c)(2)

3. “Allowing one or more survivors to receive the estate will enable him or her or them to discontinue eligibility for public and/or medical assistance.” 1 T.A.C. §373.209(c)(3)

4. “The Medicaid recipient received medical assistance as the result of a crime, as defined by Texas law, committed against the recipient. 1 T.A.C. §373.209(c)(4)

OR

5. “Other compelling reasons. 1 T.A.C. §373.209(c)(5).

6. Additionally, an undue hardship waiver can be granted to avoid estate recovery against the decedent’s homestead. 1 T.A.C. §373.209(d). The regulations setting out the homestead waiver are extensive but essentially may be granted to heirs or lineal descendants whose gross family income is less than three times the federal poverty rate (see Appendix VI). The waiver will allow \$100,000 of the fair market value to be exempted from estate recovery for qualified claimants.

Concern: If multiple heirs do not all meet the financial requirement, then only the qualified heir’s or legatee’s undivided interest can qualify for the undue hardship waiver. It will be interesting to see how the heir with the least income will be able to buy out the more prosperous heirs or legatees in order to preserve the homestead.

Concern: As written, this rule has created significant obstacles to obtain a hardship waiver. By basing the hardship waiver of a right to protect an inherited homestead on family income, the state is penalizing married persons and encouraging the break up of families to protect a right to inherit

Concern: Any person wanting to claim this waiver must provide the Medicaid agency with sufficient documentation to prove the family income. There may be heirs or legatees who do not want to reveal confidential information thus subjecting part of the homestead to estate recovery.

In order to obtain an undue hardship waiver, a family member will have to ask for the waiver, in writing, immediately after the Notice of the intent to recover is sent. The State has up to 30 days from the date it finds out about the nursing home resident’s death to send a Notice of Intent to File a Claim (1 T.A.C. §373.205); but that notice could come just days after death. Regardless, once that notice is received, the person requesting a waiver has 60 days from the date on the notice to request the waiver. (1 T.A.C. §373.209.) Additionally, that notice can be sent to the administrator or executor of the estate, the surviving spouse, the agent under a durable power of attorney or medical power of attorney or any person who represented the recipient before the Department. 1 T.A.C. §373.307.

Concern: If a person wants to claim an undue hardship or ask for reimbursement for the expense of caring for the homestead, the person will have less than 60 days from the date of Notice of the Intent to Recover to make a claim AND provide supporting documentation for a claim. The person who wants to make such a claim may not be the person who receives the Notice of Intent to Recover and may lose the right to make the claim.

Additionally, the Commission will not grant a waiver just because the person requesting it would lose an inheritance or legacy.1 T.A.C. §373.209. This rule also states: “An undue hardship does not exist solely because the circumstances giving rise to the hardship were created by, or the result of estate planning methods under which assets were sheltered or divested contrary to the requirements of Medicaid law in order to avoid estate recovery.” 1 T.A.C. §373.209.

Concern: The language of the proposed rules suggests citizens will be penalized for exercising their rights under the law to do legal estate planning. If for example an applicant transfers assets and suffers a penalty for that transfer, the medicaid recipient’s family will also be penalized by disqualifying the heir or legatee from obtaining an undue hardship waiver. Under the federal guidelines, undue hardship is disallowed for any illegal estate planning; however, the State of Texas has chosen to disallow the undue hardship waiver even when a person has acted legally!

j. Are there any deductions from Estate Recovery? Yes. **Texas Rules** allow for deductions of direct costs of care that one paid that resulted in keeping the Medicaid recipient out of the nursing home and for maintenance of the homestead. “Necessary and reasonable expenses for maintaining the home include real estate taxes, utility bills, home repairs, and home maintenance expenses such as lawn care.” 1 T.A.C. §373.213. The person claiming the deductions must request the deduction in writing on or before 60 days from the receipt of the State’s Notice of Intent to File a Claim and that request for deduction must have all necessary supporting documentation. 1 T.A.C. §373.213.

k. Can a person appeal a denial of an undue hardship or deduction for out-of-pocket expenses? The Texas Proposed Rules state that a person who is denied an undue hardship or reduction for out of pocket expenses would only be entitled to an informal reconsideration. 1 T.A.C. §373.211

Concern: There is some belief at HHSC that the right to the property is not an entitlement and thus there is no due process issues by denying a formal appeal. However, in Texas, property vests on death subject only to creditor’s rightful claims. And creditors must establish their right to their claim. It is, therefore, this author’s belief that due process must be afforded to any person claiming an undue hardship waiver or deduction from estate recovery.

l. Can a person avoid estate recovery by gifting away assets prior to death? Please keep in mind that if the nursing home resident gives away cash or land or personal property or any asset, the nursing home resident may be ineligible for Medicaid benefits for a period of time. In order to determine the period of ineligibility, the amount of the gift is divided by the average cost of nursing home care. 1 T.A.C. §358.430. The gifting penalty calculation is as follows:

$$\text{\$10,000 gift} \div \text{\$130.88 (average daily cost of nursing home care)} = 76 \text{ days}$$

Prior to November 1, 2005, the medicaid agency dropped any fractional amount of disqualification. However, effective November 1, 2005, the method of calculating the period of ineligibility was changed to determining the penalty in days rather than in calendar months .⁸⁰

m. Are there any exceptions to the disqualifying transfer rule? If a person is applying or is eligible for Medicaid nursing home benefits, that person may gift without penalty in certain instances.

- To the spouse
- To a minor child
- To a child who is blind or disabled (according to the Social Security Administration definition of disability)
- To a child who lived with the applicant in the home for at least 2 years prior to admission to a nursing home or other medical facility and provided care that enabled the applicant to remain home during that 2 year period.
- To a sibling with an equity interest who has lived with the applicant in the home for at least one year prior to admission to a nursing home or other medical facility
- To a trust for a person under age 65 who is disabled according to the Social Security Administration definition of disability.
1 T.A.C. §358.430.

Looking back at paragraph “h” above, notice that the first three transferees are the same as the exemptions to estate recovery but not the last three.

Concerns then arise when planning for an elderly person. Does a practitioner assist in transferring the house to the child or sibling or refrain from transferring the property? What about issues of exploitation? Remember, Texas Human Resources Code §48.002 (3) defines exploitation of an elderly person as follows:

“‘Exploitation’ means the illegal or improper act or process of a caretaker, family member, or other individual who has an ongoing relationship with the elderly or disabled person using the resources of an elderly or disabled person for monetary or personal benefit, profit, or gain without the informed consent of the elderly or disabled person.”

At the San Antonio Forum, there was one grandchild who commented that she was living in grandmother’s house, maintaining it and was supposed to receive the house as a legacy under grandmother’s will. She posed a frightening question to the HHSC representatives: “If I take my grandmother home from the nursing home, will that prevent estate recovery so I can inherit the house?” What about those children or siblings who, fearing their loved one may go into the nursing

home, pressure her into transferring the home, then sell it, pocketing the proceeds and move away, leaving the “loved” one to live out her days in a nursing home.

B. SUPPLEMENTAL SECURITY INCOME (“SSI”)

1. Defining the program. Supplemental Security Income, frequently referred to as SSI, is a governmental program that provides minimum income to a disabled individual who otherwise would have no or very little income.⁸¹ If an individual receives just \$1.00 of SSI, that individual is eligible for Medicaid benefits (which is essentially no-cost health insurance) including some prescription medication coverage.

2. Enabling Statutes. The governing statutes for SSI are found in 42 U.S.C. §1381 et seq. The Social Security Administration administers the SSI program. The regulations are found in Title 20, Part 416 of the Code of Federal Regulations and the Social Security Administration relies on the Program Operations Manual System (“POMS”) for its guidelines to case workers.⁸²

FOR EASE OF REFERENCE, THIS SECTION WILL COLLECTIVELY REFER TO AN “APPLICANT” AS A PERSON APPLYING FOR SSI ELIGIBILITY OR TRYING TO MAINTAIN SSI ELIGIBILITY UNDER A CHANGE OF CIRCUMSTANCE.

3. Eligibility for SSI.

a. Resources. In order to qualify for SSI, one must meet substantially the same resource criteria as with the Medicaid program outlined in Section III.A. above, with the exception to certain assets. Social Security Administration published proposed changes to SSI rules in the *Federal Register*: January 6, 2004 (Volume 69, Number 3). According to *Federal Register*, February 7, 2005 (Volume 70, Number 24) the following changes were effective March 9, 2005:

(1) Clothing will be eliminated from the definition of income. Previously, income included receipt of “food, clothing and shelter.”

(2) There will no longer be a \$2,000 value limit on the value of household goods and personal items in the eligibility process.

(3) One car will be exempted regardless of value thus eliminating the \$4,500 limitation on a car.

b. Transfer of resources. Prior to December, 1999, there were no transfer penalties or trust rules when determining eligibility for SSI. The Foster Care Independence Act of 1999 amended 42 U.S.C. §1382b(c) setting out transfer penalty rules and trust rules for SSI eligibility.⁸³

(1) In order to calculate the number of months of INELIGIBILITY, one divides the amount of the gift by “the combined amount of the individual’s federal SSI benefit and state supplementary payment, if any.”⁸⁴

(2) While there is a 36 month look-back period for transfers of assets, if the SSI applicant made a disqualifying transfer, the maximum amount of months of disqualification is 36 months rather than the Medicaid rule of no limitation on the period of INELIGIBILITY.⁸⁵

(3) Deeming resources. “The term deeming identifies the process of considering another person’s income and resources to be available for meeting an SSI claimant’s (or recipient’s) basic needs of food and shelter.”⁸⁶ “The deeming provisions recognize some measure of family responsibility as they apply from spouse-to-spouse or parent-to-child.⁸⁷ Deemed resources will be applied whether or not the SSI applicant has access to the resources.⁸⁸ Therefore, all of the resources owned by a non-applicant spouse will be deemed to be available to the applicant spouse.

c. Income. SSI provides minimum income to a disabled person when the person has no other sources of income. The maximum benefit paid to an SSI recipient for 2011 is \$674 and for an eligible couple is \$1,011. If the applicant’s income equals or exceeds the maximum monthly benefit, then the applicant will not be eligible for SSI and the most valuable Medicaid program.⁸⁹

(1) Income defined. Income for SSI purposes has a much broader definition than the Internal Revenue Code definition. Income for SSI purposes is cash, food⁹⁰ or shelter received during a month including gifts of these items.⁹¹ Income is further defined as earned (resulting from one’s labor)⁹² and unearned (everything else)⁹³. An SSI applicant will generally lose \$1 of SSI for each \$1 of unearned income, disregarding the first \$20.00 of unearned income.⁹⁴ An SSI applicant will generally lose \$1 of SSI for each \$2 of earned income, disregarding the first \$65.00 of earned income.⁹⁵

(2) In-kind support and maintenance as income. The Social Security Administration may determine that an applicant receives income if someone else makes payments on behalf of or provides basic necessities for the applicant.

(a) One-third reduction rule. The maximum monthly income rate is reduced by one-third ($\$674 \div 3 = 224.66$ for 2011) when an applicant lives throughout a month in another person’s household and receives **both** food and shelter from others living in the household. The reduction is also applicable to an eligible couple.⁹⁶ For example, if an adult disabled child lives with the parent and pays no rent AND no board, the Social Security Administration deems that the parent is paying the rent and board for the child. The child will lose \$224.66 (one-third for 2011) of his/her SSI benefit. However, if the rent and board is a bona fide loan to the child, there may be no reduction of benefit since a loan is not considered income.⁹⁷

(b) Presumed Value Rule. “When an individual/couple receives in-kind support and maintenance in the home of another, but does **not** receive **both** food and shelter from the household in which the individual/couple lives, the value of the one-third reduction rule does not apply and the in-kind support and maintenance is valued under the presumed maximum value rule. For eligibility purposes, the amount of the presumed value rule is equal to one-third the Federal benefit rate (in effect for the month in which in-kind support and maintenance is received) for an individual or an eligible couple, plus \$20 (e.g. $\$674 \div 3 = 224.66 + 20.00 = \244.66).”⁹⁸ The amount of the one-third reduction can be rebutted with evidence of the actual value of the assets received.⁹⁹

(3) Deeming income. Similar to the deeming of resources, income of a parent or ineligible spouse may be considered income to the applicant.¹⁰⁰ “It is possible to have the income of an ineligible party deemed as part of the applicant’s income and have a one-third reduction in benefits. For example: Sam Fero, an eligible individual, lives with his ineligible spouse and their ineligible adult son in a home owned by the son. Mr. Fero and his wife make a general contribution to the household of \$100 for both. A pro rata share of household operating expenses is \$110. Mr. Fero does not have ownership interest or rental liability, is not separately consuming or separately purchasing food, does not meet his pro rata share and is not earmarking. Therefore, he is considered to be receiving food and shelter from inside the household. As Mr. Fero is living in a household that is not his own, throughout a month, with at least one person other than any child as defined in [SI 00501.010](#), his spouse, or other person whose income may be deemed to him, the one-third value rule applies. His [federal maximum monthly benefit rate] is reduced by the one-third value rule and his spouse's income can be deemed to him.”¹⁰¹

d. Other eligibility requirements. As with the Medicaid program, eligibility considerations other than resources and income are that an applicant must be (i) 65 years old, blind or disabled; (ii) reside in the United States, District of Columbia or U.S. holding; (iii) and must be a U.S. citizen or naturalized citizen, permanent resident alien or an alien who is permanently living in the U.S. under color of law.¹⁰²

4. Trust rules. SSI allows the creation of self-settled trusts that meet the Medicaid self-settled exception rules (*see supra*, Section III.A.) but does not require a reimbursement to the federal government of all SSI benefits paid out on behalf of the beneficiary.¹⁰³ Social Security regulations state that “[a] supplemental needs trust is a type of trust that limits the trustee's discretion as to the purpose of the distributions. This type of trust typically contains language that distributions should supplement, but not supplant, sources of income including SSI or other government benefits.”¹⁰⁴ Note that SSA refers to the “supplement, but not supplant” language as typical but does not require the language in order to have an SNT. In fact, for trusts created prior to 1/1/00, a trust would be considered an asset only if (1) the beneficiary has the ability to revoke the trust, (2) the beneficiary has the ability to “direct the use of the trust principal for his/her support and maintenance under the terms of the trust” or (3) if the trust contains mandatory distributions provisions.¹⁰⁵ For trusts created after 1/1/00, only trusts created by the SSI applicant/recipient (or his/her spouse) are scrutinized to determine if the trust disqualifies the SSI applicant/recipient.¹⁰⁶

C. BENEFITS FROM THE DEPARTMENT OF STATE HEALTH SERVICES (“DSHS”) AND THE Department of Aging and Disability Services (“DADS”)

1. Defining the programs. There are a number of programs available through DSHS and DADS. These programs are often regulated by statutory language found in the Texas Health and Safety Code. When Medicaid benefits are available to a client through a state facility, the Medicaid rules will apply. The following are the major programs that will be regulated by the mental health and mental retardation statutes: (i) client in a state school (administered by DADS) (ii) patient in a state hospital (administered by DSHS), and (iii) resident in a state residential care facility (administered by DADS).

2. Enabling Statutes. The Texas Health & Safety Code sets out the services provided by these agencies. The three major programs that might be affected by the funding of a trust for a program beneficiary are for a client of a community center¹⁰⁷, a patient in a state hospital¹⁰⁸ or a resident in a residential care facility.¹⁰⁹ Regulations are found in 25 T.A.C. §412 (for mental health services) and 40 T.A.C. §2.106 (for mental retardation services).

3. Income and Resources. These agencies will scrutinize a person’s income and resources to determine the extent of the person’s responsibility for payment of services. The amount of payment is generally based on a sliding scale and the Applicant, Applicant’s spouse and Applicant’s parents, if the Applicant is a minor, will be expected to contribute to the cost of care.¹¹⁰

4. Trusts. If the person is the beneficiary of a trust, the trust principal may be deemed a resource thus requiring payment for services by the trustee, notwithstanding the language of the trust. The three statutes that address the consideration of a trust for a client/patient/resident (collectively referred to as “client”) are all substantially the same, each providing a trust exception for a client, provided the principal does not exceed \$250,000.00. [*Texas Health & Safety Code, §§552.018(a) & 593.081(a)*] The exception does NOT extend to the following trust funds:

- a. a guardianship established under the Texas Probate Code;
- b. a trust established under Chapter 142, Property Code;
- c. a facility custodial account established under §551.003;
- d. the provisions of a divorce decree or other court order relating to child support obligations;
- e. an administration of a decedent’s estate; or
- f. an arrangement in which funds are held in the registry or by the clerk of a court.¹¹¹

All of the above listed un-expected trusts are types of devices that hold the client’s money. One should also note that the statutes do not prohibit the creation of a client funded trust pursuant to §867 of the Texas Guardianship Code.¹¹² If the trust beneficiary is receiving medicaid benefits while in

a state facility or program, the Medicaid rules control and the \$250,000.00 limit on trust principal is not an issue.

IV. DEFINING A SPECIAL NEEDS TRUST. So just what is a SNT? The beneficiary and the beneficiary's family should clearly understand that a SNT is for the "supplemental needs" of a beneficiary, not generally for the beneficiary's basic necessities. Originally, SNTs were strictly construed with the trustee making distributions ONLY for goods and services that were supplemental in nature. If the distribution could theoretically result in disqualifying income in the month of receipt or a subsequent disqualifying resource, then the distribution would not be made. But, SNTs have evolved to allow for distributions for almost any need, depending on the eligibility requirements of the governmental benefit sought to be preserved.¹¹³

A. STRICT SNT. An example of a strict SNT is the Arc of Texas Master Pooled Trust II.¹¹⁴ According to the terms of this trust, the trustee can only make distributions for goods and services that do not qualify as cash, food or shelter.¹¹⁵ It is irrelevant under the terms of this trust, whether or not the distribution would actually disqualify a person. It only matters whether or not the distribution would theoretically disqualify an individual. Some states require the strict SNT language to preserve eligibility for benefits.

B. BROAD SNT. An example of a broad SNT is the Arc of Texas Master Pooled Trust IV.¹¹⁶ According to the terms of this trust, the trustee can make distributions so long as the distribution would not, in reality, disqualify a beneficiary. Therefore, if the beneficiary of the trust did not want to deal with the rigors of maintaining eligibility for a governmental program, the beneficiary could withdraw from the program and then the trustee could make discretionary distributions even including cash, food and shelter because the distributions would not, in reality, disqualify the beneficiary for any governmental programs. While the ARC Trust IV trust has been approved by the HHSC for Medicaid eligibility, Social Security Administration for SSI eligibility, as well as by other agencies for mental health and mental retardation services, the broad terms of the trust may disqualify a beneficiary if the beneficiary were to move to another state.

C. DISCRETION TO PARTIALLY DISQUALIFY BENEFICIARY. Some practitioners include a provision in the trust document allowing the trustee to make disqualifying distributions to the extent that the disqualification only reduces and does not eliminate the benefit. This provision could allow a trustee to make a distribution for rent and board, resulting in in-kind support and maintenance ("ISM") up to the presumed maximum value (\$244.66 per month in 2011)¹¹⁷ along with all other distributions for the supplemental needs of the beneficiary.¹¹⁸ Caution must be taken in drafting such a trust if the beneficiary might move to another state, as other state regulations may not allow such broad trustee powers.

D. TOTALLY DISCRETIONARY TRUST. Some state programs, including Medicaid and SSI in Texas, accept totally discretionary trusts as non-disqualifying trusts, while other states require the supplemental needs language in the trust document.¹¹⁹ A totally discretionary trust gives the trustee the absolute and unfettered discretion to make a distribution for the beneficiary. In order to

preserve a beneficiary's eligibility for benefits, the trustee must be knowledgeable about the requirements of the various programs benefitting the beneficiary or must engage professionals to advise him/her as to proper distributions.

E. TWO TRUST APPROACH. Some practitioners have taken the "belt and suspenders" approach to planning. In this scenario, two trusts are created for the beneficiary, funding one Broad SNT and one Strict SNT. If the Broad trust is not successful in protecting benefits and is exhausted, the hope is that the Strict SNT will still be available assets for the beneficiary's use while receiving governmental benefits.

A variation of the two trust approach is when the parties have no intention of utilizing governmental programs but the beneficiary is developmentally disabled. In this case, there are few anticipated medical expenses.

The beneficiary may be eligible for Medicare which has no need-based criteria or may be able to purchase insurance through the Texas High Risk Pool, since medical costs are not a major issue.¹²⁰ Two trusts can be funded, allowing the most broad distributions from one trust, creating an INELIGIBILITY, but providing a safety net SNT in the event that an extraordinary medical event should occur, dissipating funds in the primary trust.

F. STRATEGIC PLANNING. When meeting with the client to discuss the creation of the supplemental needs trust, the counselor should require a meeting that would include the grantor, if the trust is a self-settled trust--the beneficiary or beneficiary's family, the attorney and the prospective trustee. While it is clear to the practitioner that a "supplemental needs" trust is probably for supplemental, not necessary items, it is invariably a surprise to the layman that this is not a debit account. Preliminary meetings will avoid unrealistic expectations and allow the trust officer to decide whether or not acceptance of the trust is advisable. A general agenda for the meeting could include:

1. The wish list. The beneficiary should be instructed to bring a wish list that sets out desired expenditures and goals and, if available, the life care plan. These resources allow for goals to be set.

2. Explanation of the law controlling court created trusts and the trust document. The beneficiary should leave this meeting with an understanding of trust law, the requirements of the trust document and the benefits provided by the trustee.

3. Procedural requirements for disbursements. The beneficiary should also understand the steps necessary for disbursements. Debit cards are not included.

G. WHAT KIND OF DISTRIBUTIONS ARE ALLOWED? A trust officer once told me, "I wish each person drafting a trust would have to administer their own trust for at least six months." Think about it. Those provisions that are purposely vague may make it difficult for the trustee to

decide whether or not it would be advisable to make a distribution.¹²¹ The following is a discussion of the administration of a trust, addressing frequent issues that arise soon after the trust is funded.

1. We need a new house--Will the trustee purchase a house for me/us?

a. The individual owns the home. A home is an exempt asset for both SSI and Medicaid. If the trust purchases a home for an individual and title is in the individual's name, then under the SSI program, there will be in-kind support and maintenance valued at no more than \$244.66 (for 2011) being one-third of the SSI maximum benefit (\$674 for 2011) + \$20 disregard amount in the month of receipt. Thus, the beneficiary would have to refund a maximum of \$244.66 for one month's partial disqualification.¹²² Be very careful with purchasing a house for a person on SSI. POMS SI 01130.100, relating to homesteads, describes evidence that a house is the principal place of residence as being an intent to make the place the home referring to an "intent to return." Unfortunately, SSA takes the position that one must live in a house in order to have an intent to return. So if you purchase a house in June, that house will cause the client to be ineligible until the client moves into the house--hopefully in June. One SSI recipient pitched a tent on the property and camped out before taking possession of the property so that he would have the requisite "intent to return."

Under Medicaid rules, if income was assessed and a letter of restitution sent, restitution being voluntary, there would be no repayment of benefits received. Since the home is an exempt resource, there would be no other penalty for the beneficiary. The Medicaid program does not require living in the property to establish "intent to return." Issues regarding estate recovery of the home are discussed in the Estate Recovery portion of this paper.

It is this author's opinion that it is better for the individual to own the home than for the trust to own the home. In a grantor trust, the trust has a payback provision that instructs the trustee to reimburse the state at termination of the trust, regardless of the age of the beneficiary. However, if the beneficiary owns the house outright, the trust would have to be exhausted and the beneficiary would have to be over age 55 and must have received certain LTC services before the house would be subject to the State reimbursement rules. Additionally, there are ad valorem tax advantages when the individual owns the home as well as a step up in basis on the individual's death.

Author's comment: Keep in mind that the Medicaid/SSI definition of "homestead" is not the same Texas constitutional or statutory definition of homestead for creditor protection. The person claiming a homestead for Medicaid or SSI benefits does not need to live in the home except for SSI's requirement of initial residency. The only requirement is that the person claiming the homestead express a subjective "intent to return to the homestead." POMS SI 01130.100.

The Deficit Reduction Act of 2005 ("DRA 2005") provides that an individual is not eligible for nursing home vendor payments by Medicaid if he/she has substantial home equity (in excess of

\$500,000). For applications for institutional services (e.g., nursing home services) or home and community-based waivers services (e.g., CBA) filed on or after October 1, 2006, if the home equity exceeds \$500,000 the individual is ineligible for:

- (1) Nursing home vendor payments (but not for other Medicaid services); and
- (2) Medicaid provided under a home and community-based waiver program; unless
- (3) The applicant's spouse, child under age 21, or blind/disabled child, is lawfully residing in the home. [*HHSC, LTC Medicaid Bulletin Number 07-03, Deficit Reduction Act of 2005, "Home Equity and Continuing Care Retirement Communities," September 25, 2006, p.2*]

Author's comment: When the trustee makes a distribution that results in disqualifying income, should there be a change of circumstance reported? Change of circumstance must be reported by the tenth day of the following month for SSI (20 C.F.R. §416.714) and by the tenth day following receipt for Medicaid. House Resolution 743 (Public Law 108-203) amended parts of the Social Security Act. Specifically, Section 201 of the Act: SSA is now authorized to levy significant civil monetary penalties against a person who fails to report a change of circumstance. In the May 24, 2004 state policy clarification memo (attached as Appendix V), the agency notes that it will begin penalizing families for failing to report a change of circumstance. Additionally, does the distribution cause other family members to lose eligibility? Recently, more and more beneficiaries have siblings who are receiving Medicaid medical benefits or temporary assistance to needy families ("TANF"). While the trustee probably has no liability to other family members, it may be advisable to point out to the parents that a distribution for one child may have an effect on the benefits of the whole family.

b. The SNT owns the home. There may be circumstances, after consideration by the Attorney Ad Litem, Guardian, family and beneficiary where it is more advisable for the trust to own the home. A home is an exempt asset for both SSI and Medicaid, even when the SNT has title to the home. The Social Security Administration takes the position that the beneficiary has equitable title to the home and thus is living in his own home.¹²³

2. Household expenses. We know that one of the exempt assets that can be owned by a Medicaid/SSI recipient is a house. Whether the recipient lives in the house or simply claims the house as his/her homestead, the recipient is concerned about how the ongoing household expenses will be paid. The trustee should be mindful that if the home is owned by the beneficiary, renting the homestead for a stream of income would result in income that could be at best, paid to a provider and at worst, cause INELIGIBILITY for benefits. Therefore, the question arises: can the trustee pay for taxes, insurance and utilities when the beneficiary owns the home? Recall that in a SNT, the distributions generally will only supplement, not supplant governmental benefits. Governmental benefits are cash for food and shelter (basic necessities). Shelter is defined by SSI

(definition adopted by Medicaid for nursing home eligibility) as “room, rent, mortgage payments, real property taxes, heating fuel, gas, electricity, water, sewerage, and garbage collection services.”¹²⁴ This is the Code of Federal Regulations provision definition. It is interesting to note that the corresponding POMS provision adds “property insurance (if required by the mortgage holder)” in the definition of shelter. The trustee could pay for the insurance premium, but to avoid confrontation with SSA, the trustee may want to avoid payment of insurance required by the mortgage lender.

Author’s comment: The question arises as to whether or not POMS carries the force of law. In the mid 90’s there were differing opinions as to whether POMS carried any force of law. A case out of California has held that POMS is designed solely for the internal use of the Social Security Administration and thus, has no force of law. *Ziff v. Chater*, 930 F. Supp. 1356 (N.D. Cal. 1996). On the other hand, a court in Florida remanded a case when the administrative law judge failed to follow POMS. *Sabo v. Chater*, 955 F. Supp. 1456 (M.D. Fla 1996). In *Christensen v Harris County*, 529 U.S. 576, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) the United States Supreme Court held that “Interpretations such as those in opinion letters--like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law”... only warrant respect.

Based on the definition of “shelter,” the trustee cannot pay the taxes and utilities without incurring income causing a person to lose eligibility or receive a reduction in benefits. However, a distribution which is a loan would not be considered income and therefore, could be used to pay the annual tax bill with the intent by the beneficiary to repay the debt.¹²⁵ There has been some discussion nationally that a payment for taxes could be made incurring only one month of ineligibility. However, POMS SI 00835.474 provides: “Bills for food and shelter items which are not paid or billed monthly (e.g. weekly, quarterly, annually, etc.) must be converted to monthly amounts.” Thus, payment of the annual tax bill in the amount of \$2400 would result in \$200 per month of unearned income to the beneficiary.

Payment of real property taxes, gas, electricity, water, sewage and garbage collection is not an issue for persons in nursing home or who are eligible for the Medicaid waiver programs such as C.L.A.S.S.¹²⁶ “The use of land alone is not a household cost.” POMS SI 00835.465. So if a trailer rental space fee is paid by a third party, to the extent that the payment is for the use of land, alone, there is no deemed income. If the trailer rental space fee includes electricity and water, then the payment of the portion of electricity and water would be income. Under SSI rules, such a payment would be subject to the presumed value rule. Additionally, the tax assessor-collector may give a tax discount if they receive written notification that a disabled individual lives in the home.¹²⁷ Utility providers (electricity, water, sewage) will generally not disconnect your service for non-payment if they receive written notice that a disabled person resides in the home.

3. The Car - Since I have so much money, will the trustee buy me a red Hummer (or convertible or truck)? It is not unusual for the beneficiary or the beneficiary’s parents to request the purchase of a vehicle. Under the SSI and Medicaid rules, the gift of a car is not income because it is an exempt asset in the month following the month of the gift. Additionally, one vehicle is now

exempt regardless of its value.¹²⁸ Title to the vehicle should be styled in the name of the beneficiary, provided the beneficiary has capacity or in the name of the caretaker-parent. To ensure that the car is not sold for cash, the trustee could be named as a lien holder on the certificate of title. The trustee could also pay the insurance premiums on the vehicle. According to a revision to POMS, effective April, 2005, a family can own one car, regardless of value. If there is a second car, it's value will be counted unless it is used for self-employment.¹²⁹ Pursuant to a policy clarification of May 25, 2004, a second vehicle can be exempt in there is a second person in the household and the second vehicle is required for work or is modified for use by (or transport of) a handicapped person. (See appendix V).

4. Parental obligation to support. Texas law requires a parent to support a minor child.¹³⁰ Additionally, a guardian of a minor's estate, who is also the minor's parent, cannot use the minor assets to pay for necessities for the minor child's support, education or maintenance unless the parent/guardian can show by clear and convincing evidence that the parent/guardian cannot afford to pay for the necessities.¹³¹ A trustee, who is a fiduciary, must make only those distributions that are reasonable. Therefore, a trustee should take care not to pay for parental obligations unless the parents cannot pay or the trust document allows for such extraordinary distributions.

What if the trust officer finds that the parent is using his/her own income for inappropriate expenditures such as gambling or drugs and the trustee is finding that there are more and more calls to provide necessities for the minor child because all of the family money has been spent. The trustee could explain to the parent that if expenditures for necessities are being requested, then the trustee and the parents would need to go to court to obtain a court order to authorize the expenditures. If the trustee perceives that the parent is neglecting the child, the trustee has an obligation to report the neglect to Child Protective Services.

Author's comment: Texas Family Code §261.109. "Failure to Report; Penalty (a) A person commits an offense if the person has cause to believe that a child's physical or mental health or welfare has been or may be adversely affected by abuse or neglect and knowingly fails to report as provided in this chapter. (b) An offense under this section is a Class B misdemeanor."

"The requirement to report under this section applies without exception to an individual whose personal communications may otherwise be privileged, including an attorney, a member of the clergy, a medical practitioner, a social worker, a mental health professional, and an employee of a clinic or health care facility that provides reproductive services." Texas Family Code §261.101

Conviction for Class B misdemeanor can result in a fine not to exceed \$2,000 and/or a jail term of up to 180 days. Texas Penal Code §12.22.

5. Parent's needs. Scenario: There is a supplemental needs trust for the benefit of a child. Child lives with Daddy who is 20 years old, working in a minimum wage job. Daddy wants to attend college to obtain a marketable skill but will not be able to work and support his child. Daddy wants the child's trust to (1) pay for tuition costs for school and (2) pay for living expenses while he is in school. Basic trust law requires the trustee to make distributions only according to the

terms of the trust. A supplemental needs trust is generally for the benefit of the disabled individual. So can the trustee make distributions for Daddy's tuition costs and parental support expenses? The trustee might consider the following alternatives:

a. Student loans. Because of Daddy's limited finances, Daddy could probably qualify for college grants, subsidized and non-subsidized loans. Trustee could assist Daddy in applying for grants and subsidized loans that would pay for tuition and books. Additionally, the trustee could help Daddy obtain non-subsidized loans along with budgetary counseling to pay for parental support. Suppose Daddy were to attend a trade school instead of college. Favorable higher education loans may be unavailable. Or if college loans were insufficient, the trustee might consider:

b. Loans out of the trust. The trustee might consider making the education and support loans to daddy and including certain grade requirements as part of the loan conditions. Of course, the power to make loans should be addressed in the trust instrument.

c. Court approval of payments out of the trust. The trustee could ask the court, under the Declaratory Judgment Act (Texas Civ. Prac. & Rem. Code §37.004) to declare whether or not the payment of Daddy's tuition and the family's costs of living during education would be within the terms of the court created trust. If circumstances warrant, the trust might even be judicially modified to include language for some method of distribution. If, during the preliminary discussion of a wish list, the issue of Daddy's desire for an education arises, the trust document might include a court clarification in the trust documents allowing for specific expenditures.

d. Paying parent a wage. In many instances, a parent may significantly curtail or even quit a job in order to provide the quality of care that the disabled beneficiary requires. As noted above, a parent has the obligation to support a minor child and so the loss of income could be very problematic. It is not unusual for a parent to ask to be paid for services rendered in order to replace lost income and have the ability to provide for the minor beneficiary. In *Calef v. Barnhart*,¹³² Kathleen Calef's daughter, Heather, was receiving SSI. Kathleen could not remain employed because of Heather's needs so the trust paid Kathleen \$1,000. Under the SSI rules, a parent's income is partially deemed to the child, reducing the child's SSI benefit. Kathleen wanted the income paid to her to be "earned" income like a wage or self-employment income. The Social Security Administration took the position that it was "unearned" income. (An SSI recipient loses \$1 for every \$2 of earned income, disregarding the first \$65, but loses \$1 for each \$1 of unearned income, disregarding the first \$20 of unearned income.) The New York District Court held, on review, that the income was unearned income. To be self-employed, one must show that one is engaged in a trade or business. "The record reveals that the plaintiff failed to establish that she was engaged in a trade or business or that she reported the stipend as self-employment income on her federal tax returns."¹³³ Additionally, Kathleen was not an employee because "[a]n 'employee' is regarded as anyone who has the status of employee under the 'usual common law rules.' 42 U.S.C. § 410(j)(2). Under the regulations, 'you are a common law employee if the person you work for may tell you what to do and how, when, and where to do it.' The Appeals Council properly concluded that the

plaintiff was not employed by her daughter under the common law rules because she did not demonstrate that her daughter or her daughter's SNT instructed her in the how, when, or where of her tasks or directed her actions as to which chores or activities to perform. Indeed, the plaintiff failed to demonstrate any of the employer-employee characteristics set forth in 20 C.F.R. § 404.1007(b). Thus, the plaintiff's monthly stipend was neither net earnings from self-employment nor wages from employment. As such, the Commissioner's conclusion that the monthly stipend constitutes unearned income for deeming purposes is supported by substantial evidence."¹³⁴ The Dallas Regional Office follows the holding in *Calef* typically finding that payments to a parent are typically unearned income.

e. Estate planning for the parent. A reasonable distribution may be the attorney fees for estate planning for the parent of a disabled trust beneficiary. It could be disastrous if the parent died leaving pension, life insurance or other assets, outright, to a disabled child. Additionally, the trustee may wish to purchase a life insurance policy on the life of the caretaker, with the insurance payable to the trust. If the caretaker dies, the trust will have additional funds to hire a caretaker for the beneficiary.

6. Clothing. Clothing was previously defined as one of the basic necessities and therefore a distribution for clothing would result in income to the recipient causing a person to lose eligibility for benefits. On February 7, 2005, new rules regarding clothing were published in 70 Federal Register 6340. Effective March 9, 2005, purchase or a gift of clothing is no longer considered income or in-kind support or maintenance.¹³⁵ While the medicaid program generally adopts SSI rules for application to medicaid, only, clients, the Medicaid Eligibility Handbook and its policy clarifications have not eliminated "clothing" from the definition of "income." Generally, the medicaid program cannot impose standards that are more restrictive than the SSI program.

7. Cash? A cash distribution from a trust would be income to the beneficiary, counted dollar for dollar, and could disqualify the beneficiary for benefits. Depending on the language of the trust document, the trustee may not have authority to make such a distribution. However, the trustee could make a loan to the beneficiary in order to get cash into his/her hands. A loan under SSI and Medicaid rules is not considered income¹³⁶ and therefore would not disqualify the beneficiary for SSI and/or Medicaid based on excess income. A valid loan could be made to the beneficiary to pay for the food and such a loan should not be considered a disqualifying distribution. See 20 CFR §416.1103; See also, <http://www.ssa.gov/notices/supplemental-security-income/spotlights/spot-loans.htm>. SSA Spotlights is a basic description of SSI provisions. SSA Spotlights on Loans states:

"What is a loan? A loan is anything you receive from someone that you agree to pay for at a later date. You can make the agreement with a lending institution such as a bank, or an individual, such as a friend or relative. You can make it orally or in writing, but it must be enforceable under State law.

A loan can be: cash, food, or shelter items (rent, mortgage, utility bills, etc.)."

“How does a loan affect my SSI benefit? If you enter into a valid loan agreement, the value of the cash or item you receive is not income and does not reduce your SSI benefit. However, any funds that you borrow which you do not spend in that month will count toward your SSI resource limit of \$2,000 (or \$3,000 for a couple) the next month.”

While having a written loan agreement should provide good proof of a loan, the Dallas Region of the Social Security Administration allows for oral loan agreements so long as the oral loan agreement meets the following requirements:

- Both the lender and borrower must sign a statement that sets out the terms of the oral loan agreement and those terms must match. SSA forms 2854 (Statement of Funds You Provided to Another) and 2855 (Statement of Funds You Received) should be used.
- The Borrower signs a statement acknowledging a present intent to comply with the loan agreement.
- All parties to the loan are competent to enter into the agreement. SI DAL00815.350

8. Paying the credit card debt. Scenario: The beneficiary is receiving SSI benefits, but has continuing difficulty staying within a budget that allows for only \$674 per month in disposable funds for food, shelter and incidental spending money. (2010 SSI benefit is \$674/mo. with \$20 disregard for a maximum income that can be received of \$694.) There is a supplemental needs trust for the benefit of the beneficiary. The basic premise is in-kind support and maintenance is unearned income in the form of food or shelter or any combination of these.” POMS SI 00835.020(B)(16) so if a trustee makes a distribution for food or shelter, the result would be in-kind income to the beneficiary. If the beneficiary has a credit card in the beneficiary’s name, and has the ability to obtain cash from the credit card, the beneficiary has, in effect, made a loan of money. POMS SI 00815.350(A)(1). Then, the beneficiary uses the cash to purchase food or shelter. The safe strategy would be for the trustee to pay the credit card debt as a third party vendor payment so long as the credit card was not used to actually charge the purchase of food or shelter. POMS SI 00835.400. According to POMS SI 00835.400, “payment of an individual's bills by a third party directly to the **supplier** is not income. However, anything received in kind as a result of the payment is income if it is food or shelter.”

The question becomes, is a credit card a “supplier?” There are a number of attorneys who advise their clients that purchasing with a credit card is the same as making a loan and a third party (usually a trustee) can pay off a loan by paying the lender (credit card company) without creating in-kind support and maintenance. 20 C.F.R. §416.1103(f) states that the proceeds of a loan are not income and buying on credit is treated as though you were borrowing money. What you purchase with loan proceeds is not income. Subsection (g) provides that payment of your bills by someone

else directly to the SUPPLIER of goods and services is not income. However, SSA goes on to say that if the item you receive is food or shelter, then the value you receive because of the payment is in-kind support and maintenance. Subsection (g) may not fit the example of payment of a loan because a credit card company is not a “supplier.” Additionally, (g) does not make sense in the light of *Hickman v. Bowen*, 803 F.2d 1377. In *Hickman*, the 5th Circuit affirmed that there was no reason to treat cash and in-kind income any differently. Taking that finding a step further, the court reasoned that both cash and in-kind income (i.e. food shelter) could be subject of a bona fide loan. Following *Hickman*, SSA issued Acquiescence Ruling (AR) 88-7(5) instructing the worker to document a claim that in-kind support and maintenance was a loan when there is a bona fide intention to repay. POMS 00835.482 sets out the criteria for documenting a loan of food and shelter. So you can loan a person food with the promise that the person will repay you for the food, but (g) leads one to believe that you cannot payoff someone’s loan when those funds were used to purchase food.

Notwithstanding the above logic, Dallas Regional officials have stated that a person could pay a credit card bill but if the credit card statement detail is reviewed by SSA and the payment included payments for food or shelter charges, then the caseworker would conclude that there was disqualifying income for those food or shelter items. In fact, one trustee has reported to me that the caseworker has requested the credit card detail in an audit. Thus, if the beneficiary charges food or shelter payments on the credit card, the trustee could pay all but these specific payments

Instead of wading through the minefield of loans and credit cards, the trustee might ask the family to submit a listing of all expenditures over the last 2-3 months to determine why the family cannot stay within the extravagant SSI budget. Keep in mind that items such as phone bills, dry cleaning, cable television, painting, plumbing, gasoline are not considered part of the “food & shelter” prohibited distributions. Thus, after review, there may be distributions that the trustee could make directly to the provider that would free up funds to pay the food bill.

9. Vacation: Trust beneficiary wants the trustee to pay for the family to go on vacation. The payment will include payment for meals and hotel lodging. Can the trustee make these distributions without causing the beneficiary to lose eligibility? Yes. 20 CFR §416.1149 sets out the rule. “However, if you receive in-kind support and maintenance only during a temporary absence we do not count it since you are still responsible for maintaining your permanent quarters during the absence.” POMS SI 00835.040 further clarifies that a temporary absence (e.g., a vacation) may not extend past the end of the calendar month following the month in which it begins.

10. Natural Disasters: Recently, we have seen the uncertainty that arises when a natural disaster strikes. The federal rules address the Hurricane Katrina and Rita issues of paying for food and shelter. 20 CFR §416.1150 sets out how SSA treats receipt of income in a major disaster. “The Disaster Relief and Emergency Assistance Act and other Federal statutes provide assistance to victims of major disasters. ... (1) We do not count the value of support and maintenance (in cash or in kind) received from a Federal, State, or local government source, or from a disaster

assistance organization, and the one-third reduction rule does not apply if-(i) You live in a household which you or you and another person maintain as your home when a catastrophe occurs in the area; (ii) The President of the United States declares the catastrophe to be a major disaster for purposes of the Disaster Relief and Emergency Assistance Act; (iii) You stop living in the home because of the catastrophe and within 30 days after the catastrophe you begin to receive support and maintenance; and (iv) You receive the support and maintenance while living in a residential facility maintained by another person.” *Id.*

There are additional exceptions when a person receives support and maintenance (in cash or in kind) from a private source. “We do not count the value of support and maintenance (in cash or in-kind) received from any other source, such as from a private household, and the one-third reduction rule does not apply for up to 18 months after you begin to receive it if- (i) You live in a household which you or you and another person maintain as your home when a catastrophe occurs in the area; (ii) The President of the United States declares the catastrophe to be a major disaster for purposes of the Disaster Relief and Emergency Assistance Act; (iii) You stop living in the home because of the catastrophe and within 30 days after the catastrophe you begin to receive support and maintenance; and (iv) You receive the support and maintenance while living in a residential facility (including a private household) maintained by another person. *Id.*

“(c) Other assistance you receive. We do not consider other assistance to be income if you receive it under the Disaster Relief and Emergency Assistance Act or under another Federal statute because of a catastrophe which the President declares to be a major disaster or if you receive it from a State or local government or from a disaster assistance organization. For example, you may receive payments to repair or replace your home or other property. (d) Interest payments. We do not count any interest earned on the assistance payments described in paragraph (c) of this section.”

11. Wedding cake and invitations or Love -- Thailand Style. One trust officer received a request to purchase a wife out of the principal of a court created supplemental needs trust. The Beneficiary — who had never been very social — wanted a wife and found that he could purchase one from Thailand. Problem was that according to Thailand law — the beneficiary must go to Thailand for at least 90 days before the deal could be finalized and meet with the ministry of matrimony. This Beneficiary was receiving Supplemental Security Income (“SSI”), a needs-based government benefit. Social Security Administration law says that SSI recipients cannot go out of the country for more than 30 days at a time. He had a severe medical condition and could not afford to be off of his Medicaid for an extended period.

a. The Trustee became counselor and convinced the Beneficiary that shortly after arriving in America, the Thai wife would become Americanized which would probably end up as a poor investment.

b. If, in addition to or instead of receiving SSI, a disabled adult was receiving Disabled Adult Child (“DAC”)/ Childhood Disability Benefits (“CDB”) based on the parent’s work record, the beneficiary would lose DAC/CDB upon marriage. (*Califano v. Jobst*, 434

U.S. 47 (1977). If the DAC/CDB is based on a retired worker's work record, then the child would get 50% of the worker's Social Security amount which is outside of any payment paid to the worker. If the DAC/CDB is based on a deceased worker's work record, then the child would get 75% of the worker's Social Security amount which could be up to \$1800, tax free money, per month. (20 C.F.R. §353(a)). While payment for wedding invitations and wedding cake might not result in a breach of trust or fiduciary duty, it would certainly warrant discussion.

12. Hanna Montana or Rose Bowl Tickets. A trustee of a SNT was the father of the disabled teenage girl. The trustee made expenditures for items that would make his daughter/beneficiary happy, including a snowmobile and tickets to see Hanna Montana. As in Texas, the Minnesota court required the trustee to account to the court on an annual basis.¹³⁷ On review, the district court denied distributions for a snowmobile and Brittany Spears tickets while approving the purchase of a bicycle and payment of other outings. The Court of Appeals ruled that the district court's disallowances were arbitrary stating: " Whether Hanna Montana concert tickets are an appropriate expenditure for a 14-year-old," the court writes, "requires an exercise of discretion: parents of disabled and non-disabled children are constantly faced with such discretionary decisions. . . we conclude that [Mr. Collins] exercised, but did not abuse, his 'sole discretion' in providing a child's snowmobile and concert tickets for Jennifer."¹³⁸

13. Payments after beneficiary dies. What payments can the trustee make out of an SNT after the beneficiary dies? The trustee will, of course, look to the trust document. But what if there are allowable distributions that do not conform to program rules. Following the death of a beneficiary, there are certain expenditures that the trustee may make prior to reimbursing the state: (1) "Taxes due from the trust to the State or Federal government because of the death of the beneficiary;" and (2) "Reasonable fees for administration of the trust estate such as an accounting of the trust to a court, completion and filing of documents, or other required actions associated with termination and wrapping up of the trust." POMS SI 01120.203.B.3.a. Notwithstanding the provisions for distributions in the trust document, expenditures that are not allowed after the beneficiary's death are: (1) Third party debt, (2) funeral expenses, and (3) distributions to residual beneficiaries. POMS SI 01120.203.B.3.b. Thus, it would be extremely important for a trustee to look to prepay a funeral for a beneficiary.

Shewry v. Arnold, 22 Cal. Rptr. 3d 488 (Cal.App. 2004, no writ) is an interesting case of note. In this case, mother had funded SNT.. Mother died leaving adult disabled child. Trustee distributed all funds from trust just before mom died to the disabled daughter except \$2.31. State demanded reimbursement from the trustee but trustee refused to reimburse state. State sued. The Court said 1396p(b)(1) controls for estate recovery and there is no estate recovery when there is a surviving disabled child.

14. Anticipate needs. Beneficiary of the supplemental needs trust is an adolescent with anger control issues. The trustee made a routine visit and found holes in the wall along with a stove with no stove door creating expensive repair bills for the trust to pay. While having the house and stove repaired, it may be appropriate to obtain counseling for Johnny Beneficiary for anger

management. Additionally, it might even be justifiable to pay for counseling for the family or at least the caretaker to help manage JB's anger. Employment of a case manager to evaluate the situation might also prove cost effective in the long run.

H. SUPPLEMENTAL TRUST PROVISIONS.

1. Annual Care Report. A supplemental needs trust is just that—for supplemental needs. But how would a trustee know over a beneficiary's lifetime, just what the beneficiary's supplemental needs are? One might include a provision in the trust document that requires "an annual care report by a licensed social worker or therapist reporting on the beneficiary's quality of life, goals, care, options, objectives, concerns, desires and other key factors...."¹³⁹

2. Care coordinator. A care coordinator may be advisable in order to advise the trustee on the special needs of the beneficiary. "Care coordinators pull together many fragmented pieces of legal plus social plus medical care and can often identify gaps and safety nets."¹⁴⁰

3. Life Insurance on parent on caregiver's life. Including a provision that allows the trustee to purchase a term life policy on the parent or caretaker's life would provide additional funds in the event of an untimely death.

4. Congress, death and the estate tax. The Estate Tax although gradually repealed has a sunset provision in 2011. As the law exists as of January 2006, the estate tax exemption for an individual was \$2,000,000 for years 2006-8, \$3,500,000 for 2009 and no estate tax as of 2010. In 2011, the estate tax repeal expires and the exemption was to revert to a \$1,000,000 exemption amount. However, on December 17, 2010, President Obama signed into law the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" which sets the federal estate tax exemption at \$5,000,000 per person. This act is only set to be in force for 2 years. When creating a trust, especially a self-settled trust funded with a structure, the practitioner should take care that any estate tax issues are addressed at funding. Where there is a possible estate tax issue with a structure, practitioners generally agree that a 50% commutation clause in the annuity product would probably be sufficient when coupled with other trust assets to pay estate tax.

5. Payment of the funeral and attendant expenses. The trust should have a provision that allows payment of funeral and attendant expenses or the trustee should prepay all expenses prior to termination of the trust.

6. Discretion to fund the Arc of Texas Master Pooled Trust. The grantor may create a trust for a disabled beneficiary naming an individual or bank as the trustee of the trust. At some point in the administration of the trust, the trust assets may become too small to cost-effectively manage for a corporate trustee or too complex for an individual to manage. The grantor can include a provision in the trust document that allows the trustee to transfer the corpus of the trust to the Arc of Texas Master Pooled Trust.¹⁴¹

7. Doctrine of Worthier Title. Remember the Doctrine of Worthier Title? How long has it been since this issue has arisen? Many of us have not thought of this Doctrine since law school. Recall that the Doctrine of Worthier Title provides that if the grantor is the sole beneficiary then the trust is revocable. Under common law, leaving an estate to heirs would not be a remainder but actually a reversion to the grantor and his progeny. Texas has abolished the doctrine by statute in Texas Property Code §5.043, leaving it a rule of construction—that is to say, the court will look

at the intent of the Grantor. That said, the Social Security Administration relies on state law to determine if, under state law, by naming heirs or the grantor's estate as the taker on the grantor's death results in a reversion as opposed to a remainder. If there is no remainder beneficiary, then the grantor is the sole beneficiary and the trust is revocable, regardless of the wording of the trust. In Texas, creating a grantor trust is often by Statute, as is discussed throughout this paper—Texas Property Code §142.005 or Texas Probate Code §867. Those statutes require that at the death of the grantor, the trust proceeds be paid to the grantor's estate representative.¹⁴²

The current Dallas regional POMS supplement provides some guidance on whether or not a trust is revocable. The terms, "heirs" and "next of kin" are generally not considered "residual beneficiaries" following the old common law rule. Terms such as "children," "descendants" and "issue" meet the residual beneficiary definition. But as noted above, State statutes require that the remaining funds in the trust be paid to the estate representative which could easily be considered a reversion to the grantor and leading to a determination that the trust is revocable.

This author certainly advises following the statutory requirements. But the following case may be instructive. In *Kemble v. Barnhart*,¹⁴³ the Illinois Federal District Court was reviewing whether or not a determination that a Supplemental Needs Trust was revocable. Since 1986, Kemble had been considered disabled by SSA. In 1997 Kemble recovered funds from a personal injury suit which were placed in a SNT pursuant to a court order. The court was the grantor and Kemble's sister was named the trustee. Kemble was the primary beneficiary and the State was the sole successor beneficiary. The trust contained a State payback provision. In 1998 Kemble gave notice that she was the beneficiary of the SNT. The Assistant Regional Commissioner asked for a legal opinion from the Office of General Counsel. In 1999, the Commissioner concluded that the principal in the trust should be considered a resource for SSI purposes, because as grantor and sole beneficiary, Kemble could revoke the trust and use the trust principal for her support. Thus, in 1999, she was deemed ineligible for benefits. Kemble went through the administrative appeal process and in 2001 filed for a judicial review of the denial of SSI eligibility and an opinion was issued in her favor in March 2004 (resulting in 5 years without benefits).

The pertinent trust provisions stated:

"Pursuant to Art. 3 below, the State of Illinois is the sole successor beneficiary and accordingly, shall receive all amounts remaining in the trust upon death up to an amount equal to the total assistance paid on her behalf...."

"Unless sooner terminated by exhaustion of corpus, or otherwise, the trust shall terminate upon the death of Kemble. Specifically in accordance with 42 U.S.C. §1396p(d)(4)(A) and Illinois Administrative Code, the Trust assets remaining at death of Kemble shall be paid to the appropriate state agencies, as reimbursement to the State of Illinois for benefits provided to Kemble during Kemble's life. Any assets remaining after reimbursement to the State are to be distributed to Kemble's estate.

“The ALJ found that “the naming of the state of Illinois as sole beneficiary of the trust, to repay Medical Assistance received, does not create a named residual beneficiary of the trust.” ®. 13)...The ALJ’s reasoning would be more persuasive if nothing in the Trust indicated an intent to go beyond what was required to create a Medicaid Trust. The ALJ improperly disregarded the unambiguous Trust language which indicates an intent to do more than just preserve Kemble’s eligibility for Medicaid benefits. Kemble named the State of Illinois as the “sole successor beneficiary,” which was not necessary to qualify for Medicaid benefits....Here, the Trust did not merely require that upon Kemble’s death, the Trust would reimburse the State for Medicaid benefits paid on Kemble’s behalf. Kemble specifically named a particular entity, the State of Illinois, as the “sole successor beneficiary.” Under the Commissioner’s own policies, this designation is specific enough, and the Trust is irrevocable. The Commissioner asserts that if Kemble had named other beneficiaries, such as family members, to receive any remaining assets after the State was reimbursed, the Trust would be irrevocable. Def’s Memo., p. 14. The Commissioner’s position that the Trust must specify a particular person as opposed to a particular entity as the residual beneficiary to be deemed irrevocable has been explicitly rejected by POMS SI CHI01120.200(D) which recognizes that specially named entities are considered beneficiary.”

V. SELF-SETTLED SPECIAL NEEDS TRUST. A trust funded with funds belonging to the grantor or the grantor’s spouse is a self-settled trust.¹⁴⁴ A self-settled funded SNT is allowable in light of the self-settled trust exceptions created in OBRA’93 and previously described as the “A” or “C” trusts.¹⁴⁵

A. FUNDING THE SELF-SETTLED SNT.

1. Funding with grantor’s current funds. Assume that the Applicant owns countable assets in excess of the Medicaid/SSI cap (in most cases \$2000). If an individual is under the age of 65, the assets could be transferred to a SNT for the benefit of the beneficiary without incurring transfer penalties, provided the trust complied with the provisions of the “A” or “C” statute.¹⁴⁶ Funding a self-settled “A” or “C” trust would have to be closely scrutinized in light of the Trust exception rules outlined in Section III.C.4. of this paper.

2. Funding with a personal injury recovery. Funds from a personal injury recover may be used to fund a “A” or “C” trust. Prior to OBRA’93, personal injury funds were paid directly into a SNT by a defendant rather than paying the funds to the disabled plaintiff and then the plaintiff funding a trust. Some states took the position that if the funds did not come into the hands of the plaintiff, the funds did not “belong” to the plaintiff and therefore, the trust was not a self-settled trust. OBRA’93 made it clear that funds from a personal injury recovery belong to the plaintiff and therefore, the trust will be considered self-settled.¹⁴⁷

a. Funding with a structured settlement arising from a personal injury recovery.¹⁴⁸ “Structured settlements are settlements in which there is typically an immediate lump sum payment, followed by a series of multiple payments over time, rather than a single lump sum cash settlement.”¹⁴⁹ The structure, when obtained at settlement of litigation, can be paid over time, tax free.¹⁵⁰ “There are still further tax advantages to the use of a structure. If the plaintiff were to settle for a lump sum, the money received would be tax free. In most cases, however, the plaintiff will not spend all of the money on the first day, but will probably invest a substantial portion of the

settlement proceeds in some investment vehicle, even if it is as simple as a Certificate of Deposit. The earnings on any such investment will be subject to taxes, leaving the plaintiff with a reduced net recovery. Had the principal been invested by the defendant [in a structure paid out as an annuity stream of income], the monthly benefits generated would be totally tax free.”¹⁵¹ The initial lump sum settlement proceeds can be used to fund a SNT with the annuity payments paid to the trustee. Additionally, the trustee should not claim a commission on the collection of the annuity since the structured is a return of principal.

b. Funding with a Medicare set-aside trust. Currently, when an individual receives Workers Compensation benefits and Medicare payments during disability, any recovery for future medicals in a personal injury suit must be paid into a Medicare set aside trust. Medicare will not pay for future medicals until the Medicare set aside trust is exhausted. The provisions of the set aside trust allow payments for only those items that would be allowed under a government Medicare program. There has recently been some discussion about the Social Security Administration taking the position that when a judgment in the personal injury lawsuit recovers specific future medicals for an individual, that recovery must be directed to a Medicare set-aside trust before Medicare will pay future medicals. It is not at all unusual to use funds in a SNT for the purchase of a house and a van equipped with a lift resulting in distributions of about \$300,000. There has been a recent undocumented incident in Arizona where the Medicare program contacted the Personal Injury attorney requesting an accounting of expenditures that have been made out of the future medicals that were recovered.¹⁵² Thus, anyone dealing with personal injury funds held in trust should be alert for any changes in the Medicare rules.

3. Divorce. In a divorce action, there will be an equitable division of assets between the spouses and child support will be considered for minor and even adult disabled children. When representing a client who is disabled or who has a disabled child, the attorney should at least consider steps that might be taken to preserve eligibility for governmental benefits.

a. Spousal division of assets and maintenance. The Texas Family Code requires a just and right division of assets upon a divorce.¹⁵³ Additionally, a court may grant monthly maintenance to a spouse during separation or after marriage.¹⁵⁴ But if the spouse is disabled, additional income or assets may cause the spouse to be disqualified for valuable governmental benefits. The Family Code allows parties to enter into settlement agreements incident to divorce.¹⁵⁵ The counselor would best serve the client to at least consider the possible creation and funding of a SNT in the divorce action to preserve the client’s eligibility for benefits.

b. Child support. The Texas Family Code also provides for support for a minor child and a disabled adult child.¹⁵⁶ In fact, section 154.301 allows a court to order payment of child support after age 18 upon a finding that: “(1) the child, whether institutionalized or not, requires substantial care and personal supervision because of a mental or physical disability and will not be capable of self-support; and (2) the disability exists, or the cause of the disability is known to exist, on or before the 18th birthday of the child.” There is no requirement in the statute to determine if such an order would cause a child to lose valuable governmental benefits. In fact, when a disabled person reaches 18 years of age, that person can apply for SSI and with SSI benefits obtain valuable no-cost health care through the Medicaid program. An even more valuable Medicaid waiver program is the Community Living Assistance and Support Services program designed

specifically for persons whose onset of a developmental disability occurred prior to age 22. This author believes that failure to consider eligibility issues as they relate to child support could lead to attorney liability for loss of benefits.

B. WHO WILL FUND THE SELF-SETTLED TRUST? In order to fund a self-settled SNT, one must utilize the “A” trust or the “C” trust. Who signs the trust document. The “A” trust statute specifically states that the trust is created by a parent, grandparent, guardian or court.¹⁵⁷ While the self-settled trust provisions have already been discussed in Section III, *infra*, one should keep in mind that often a judge must be convinced of the appropriateness of this trust. In a case out of New York, the judge refused to allow the creation of a SNT since the ward’s income exceeded her necessary expenses. The judge noted that “this is unlike a situation in which it is demonstrated that the expenses will exhaust an incapacitated person’s funds, thus rendering them impoverished. Here it appears that there are sufficient funds to meet [her] needs and to provide ‘luxuries’ as might be supplied by a SNT.”¹⁵⁸

C. SUBROGATION.

1. Medicare. If Medicare pays for the medical expenses (i.e., doctors fees, hospitalization costs and other medical expenses) of a claimant arising from a personal injury, then that Medicare expenditure is subject to recovery if the claimant should receive a settlement of a claim or collect on a judgment.¹⁵⁹ The right of subrogation is statutory and is more compelling than the common law right of subrogation.¹⁶⁰ Medicare’s superior subrogation right takes priority over other claims.¹⁶¹

During the past few years, there has been much controversy over whether or not Medicare had a right of subrogation in every instance. In *Thompson v. Goetzmann*, the plaintiff sued hip prosthesis manufacturer for products liability and settled for \$256,000 with no itemization of basis for settlement. Medicare had paid over \$140,000 in medical expenses in connection with plaintiff’s hip surgery. When settlement proceeds were distributed without satisfying Medicare’s claim, Medicare filed lawsuits against prosthesis manufacturer (from whom it sought double damages), plaintiff and plaintiff’s counsel seeking recovery of settlement proceeds. Medicare cited the Secondary Provider statute (“MSP statute”) and insisted that it creates a right in Medicare to secure reimbursement from personal injury, products liability and any other tort recovery for payments that Medicare made as a result of the injury. Federal District Court dismissed the government’s claims, holding that the MSP statute addresses only insurance plan payments or payments under a plan of self-insurance. Government appealed, asserting that the hip manufacturer was “self-insured for its liability to” plaintiff. Circuit Court of Appeals affirmed the lower court holding, noting that the government’s position has been soundly rebuffed by every District and Bankruptcy Court addressing the question. If the product liability/personal injury payments are not pursuant to a plan of insurance the MSP statute does not apply. Furthermore, the mere fact that the government is given a right to pursue a personal injury action on behalf of a Medicare beneficiary (the Medical Care Recovery Act--42 USC section 2651-53) does not mean that the government has acquired some sort of lien against the proceeds of the litigation.

In response to *Goetzmann*, Congress enacted the “Elder Law Attorneys’ Continued Employment Act” otherwise known as the Medicare Prescription Drug Bill. On December 8, 2003, President Bush signed the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act of 2003), Public Law No. 108-173. This legislation contains section 301 which essentially repeals *Goetzmann*. Medicare secondary payer provision “expands the definition of "primary plan" which has the obligation to pay first beyond a group health plan, large group health plan, workers' compensation plan, automobile or liability insurance policy or plan (including a self-insured plan) or no fault insurance. Now, an entity that engages in a business, trade, or profession is deemed to have a self-insured plan if it carries its own risk, whether by failure to get insurance or otherwise, in whole or in part.”¹⁶² Additionally, “The Act expands those who have an obligation to reimburse Medicare for conditional payments to include a primary plan and an entity that receives payment from a primary plan, such as the attorney who receives payment from the primary plan. Responsibility of a primary plan to make payment may be demonstrated by a judgment; a waiver, or release of payment included in a claim against the primary plan or the primary plan's insure. Reimbursement must be made before the expiration of the 60-day period beginning on the date notice of, or information related to, a primary plan's responsibility for payment is received, or else Medicare can impose interest. The Act also expands the parties against whom Medicare may recover payment to include any or all entities that are or were required or responsible to make payment under a primary plan.”¹⁶³ Finally, “These provisions are made effective as if included when the amended Medicare Secondary Payer provisions were enacted in the 1980's.”¹⁶⁴

To determine the subrogation amount, one should contact
TrailBlazer Health Enterprises
Medicare Secondary Liability
P. O. Box 9020
Denison, TX 75021-9020
(903) 463-0641 (8:00 a.m.-noon, M-F)
(903) 463-0642 (fax)

When requesting the subrogation amount, the request should include “the beneficiary’s name; the beneficiary’s HIC number (usually the Social Security number, but not always); the date of the accident or onset of illness involved in the liability claim; a description of the type of injury or illness; and medical authorization.”¹⁶⁵ Medicare should respond to the inquiry within 45 days.¹⁶⁶ If the Medicare subrogation right is not paid and Medicare must take legal steps for recovery, the subrogation statute allows Medicare to recover double the amount of its claim.¹⁶⁷ The subrogation claim may be waived if waiver would be in the Medicare secondary payor program’s best interest¹⁶⁸ or based on a financial hardship.¹⁶⁹

2. Medicaid. According to Texas law, the Medicaid program has a right of subrogation on proceeds that are recovered by the recipient for payments Medicaid has made for medical services.¹⁷⁰ But the Medicaid program has more than a right of subrogation. Texas law provides that "the filing of an application for or receipt of medical assistance constitutes an assignment of the applicant's or recipient's right of recovery from: (1) personal insurance; (2) other

sources; or (3) another person for personal injury caused by the other person's negligence or wrong." Trying to nail down the distinction between subrogation and assignment is like trying to nail water onto the side of a barn. However, one foreign court hung a bucket when it defined the differences as follows: "There is a controlling difference in Missouri between the assignment of a claim and subrogation to a claim. When there is an assignment of an entire claim there is a complete divestment of all rights from the assignor and a vesting of those same rights in the assignee. In the case of subrogation, however, only an equitable right passes to the subrogee and the legal title to the claim is never removed from the subrogor, but remains with him throughout."¹⁷¹ Thus, if one were to apply the Missouri distinction between assignment and subrogation, the Texas statutory assignment results in the recipient's entire claim belonging to Medicaid up to an amount paid out on behalf of the recipient before the recipient has any right to recover.

In *Texas Dept. of Health vs. Buckner*, the Court held that "once the Buckners received Medicaid assistance for Iesha's medical treatment, any cause of action or right of recovery arising from her injury, up to the amount the TDH expended for her care, was assigned to the TDH as a matter of law."¹⁷² The question then arises, can a properly drafted claim limited to pain and suffering, omitting any past medical expenses foreclose recovery by Medicaid? In *Buckner*, the Medicaid program's right to recover specifically included the rights to "any claim filed on behalf of or payment made to a Medicaid recipient for injuries requiring Medicaid services including payments for mental anguish, pain and suffering, and future medical expenses when the injury causing the need for Medicaid services was the basis for those claims or payments."¹⁷³ This broad right of recovery was based on the Texas Administrative Code section 28.101, Title 25. However, effective September 1, 2001, section 28.101 and similar sections were repealed and replaced by Title 1, Chapter 354J.¹⁷⁴ The specific provisions of section 28.101 defined recoverable medical services as including payments for "mental anguish, pain and suffering and future medical expenses." The author finds no clear definition of medical services in the new Chapter 354J. However, in 1 T.A.C. §354.2322, a provider, for billing purposes, is required to determine "at the time services are delivered or at any time thereafter, whether the services being provided to the recipient are a result of injuries caused by a person who is or may be liable for payment for the services" not limiting the services to medicals. So, this author believes that there is an open question as to whether the intent of changing the administrative rules in 2001 was to overrule that portion of *Buckner* that required payment from the total recovery or if *Buckner* is still good law.¹⁷⁵ Prior to disregarding the *Buckner* holding, a practitioner should review the relevant Texas Administrative Code sections that became effective September 1, 2001¹⁷⁶ including section 354.2315, Title 1, that provides: "The department must be paid all amounts owed under this chapter [354J] prior to placing any proceeds from a third party into a trust created under the provisions of the Social Security Act §1917(d)(4) (codified at 42 U.S.C 1396p(d)(4)), unless the department agrees otherwise."

Under the Texas Administrative Code effective September 1, 2001, the Medicaid recipient has an affirmative duty to notify Medicaid of any unsettled or pending claim.¹⁷⁷ An Attorney or Representative of the recipient has a duty to notify the Medicaid program "within 45 days from the date the attorney or representative undertakes representation of the recipient, or from the date a potential third party is identified."¹⁷⁸ Section 354.2315 sets out the requirements of the notice.

Finally, under the new administrative code section, there is a limitation on the amount of attorney fees recoverable. Keep in mind that the claim was assigned to Medicaid by the recipient and so representation of a recipient recovers funds belonging to Medicaid. The attorney fees paid out of the amount recovered by Medicaid is limited to 15% of the entire amount recovered on behalf of the Medicaid program.¹⁷⁹ Reimbursement for expenses are limited to “reasonable” expenses. The fee limitation will not be problematic if the gross recovery is sufficient to pay the Medicaid claim and attorney fees. The problem of obtaining attorney fees and expenses arises when the Medicaid claim equals or exceeds the recovered amount.

Recovery can be claimed for two separate payments that were advanced as a result of an injury. To determine the recovery amount, one should contact

I.

(increase in nursing home tile rating)
Texas Department of Aging and Disability Services
TDS Recovery
Mail Code Y948
P. O. Box 149081
Austin, Texas 78714
(512) 490-4680 or (512) 490-4635

II.

(doctor, hospital and medical expenses)
Texas Medicaid and Healthcare Partnership
ATTN Tort Department
Mail Code A07
P.O. Box 202298
Austin, Texas 78720
(512) 506-7559

3. Hospital Lien. Texas Property Code §55.002(a) creates a statutory right of subrogation on a claim or cause of action of an injured party who is injured as a result of the negligence of another person or entity. This statute includes a right of action against anyone who pays or receives the funds, including against attorneys.¹⁸⁰

D. TROUBLESOME TRUSTS.

1. Medicaid Qualifying Trust (“MQT”). This trust sounds pretty good—medicaid qualifying trust. One would think that such a trust would help one qualify for medicaid. Not so. A MQT “is one that the client, his spouse, guardian, or anyone holding his power of attorney establishes using the client's money. The client is the beneficiary of a Medicaid-qualifying trust. A Medicaid-qualifying trust is one that was established between June 1, 1986, and August 10, 1993.

Trusts which meet the MQT definition and were established prior to June 1, 1986, are treated as standard inter vivos trusts.”¹⁸¹ The Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA 1985” - Public Law 99-272) “states that distributions from Medicaid-qualifying trusts are considered available to the client whether or not distributions are actually made. The amount available is the maximum amount the trustee could disburse if he used his full discretion under terms of the trust. If distribution is **not** made, the maximum amount the trustee may distribute if he used his full discretion under terms of the trust is considered an available resource. If trusts do not specify an amount for distribution, and if the trustee has access to and use of the principal or the income from the trust, then the entire amount is considered an available resource that may be used for the client's benefit.”¹⁸²

2. Revocable (living) Trust. A revocable trust is generally a self-settled trust created by an individual for the benefit of that individual and funded with the individual's own funds. While a "Living Trust" is an excellent tool as a management trust, the author would not generally recommend a "Living Trust" as a device to plan for Medicaid long term care benefit eligibility.

When a single person transfers assets into a living trust, HHSC takes the position that so long as the trust is revocable, it is as if the person still owns the assets (because the person can revoke the trust at any time).¹⁸³ So when the single person applies for Medicaid, the assets in the revocable trust will be countable toward eligibility.

The Texas Medicaid program has historically extended the residence exemption to an individual's home, even though the legal owner is a revocable trust. However, this practice was inconsistent with CMS guidance, which states that the homestead of an institutionalized individual which is placed in a revocable trust becomes a countable asset. [*CMS, State Medicaid Manual §3259.6.F.*] Effective December 1, 2006, HHSC began following CMS guidance by counting a home placed in a revocable trust as a resource to the extent of its market value. For applications filed on or after December 1, 2006, homestead property in a revocable trust is a countable asset. Beginning with annual redetermination packets mailed on or after December 1, 2006, any Medicaid recipient who has his/her home in a revocable trust will receive advance notice that failure to remove the home from the trust may affect eligibility. If the home is not legally removed from the trust by the annual redetermination date, it will be counted as an asset. If the individual is denied Medicaid at redetermination, owing to the homestead in the trust, and if the home is subsequently removed from the trust and re-established as a homestead, when the individual re-applies for Medicaid its equity value must be determined. If the equity value exceeds \$500,000, the individual will be placed in “Mason Manor” (Vendor Number 5997). This means that the individual will receive all Medicaid benefits except vendor payments to the nursing home. [*HHSC, LTC Medicaid Bulletin Number 07-05, Homesteads Transferred to Trusts,*” November 21, 2006, pp.2-3]

When spouses transfer their assets into a revocable living trust, there is no transfer penalty so long as the spouses can recover the property from the trust. However, when the first spouse dies, if the trust requires that the deceased spouse's property must pass into an irrevocable trust for the surviving spouse, such a transfer could result in a Medicaid disqualifying transfer penalty applied

against the surviving spouse (even if the decedent's trust for the surviving spouse had supplemental needs language). This is because when spouses create an inter vivos trust, the assets in the trust are considered assets of both spouses, disregarding the sole management community and separate property character of the asset. The federal statute defines an asset as one belonging to the applicant or the applicant's spouse.¹⁸⁴ Therefore, if one spouse predeceases and the trust provides that the deceased beneficiary's sole management community property and separate property is transferred to a trust for the surviving beneficiary (surviving spouse), the assets funding the irrevocable trust for the surviving spouse could be considered by HHSC as assets belonging to the surviving spouse, thus creating an irrevocable grantor trust subject to the grantor trust rules.¹⁸⁵

While a spouse cannot create an inter vivos trust for the other spouse to protect resources, a spouse may leave a legacy in a testamentary SNT for the benefit of the surviving spouse, and those assets should not be countable resources to the surviving spouse.

3. Trigger Trust. "After the passage of the COBRA 1985 Medicaid qualifying trust rules, sophisticated elder law practitioners started drafting trust language to circumvent the new law. One such technique was known as the 'trigger trust.' A trigger trust is a trust under which the trustee's discretion to make payments to a beneficiary is terminated if the beneficiary enters a nursing home or applies for Medicaid. Because the trustee no longer has the authority to make discretionary payments to the beneficiary, the income and principal of the trust would not be considered available under the COBRA rules."¹⁸⁶ Changes to the Medicaid provisions enacted in the Omnibus Budget Reconciliation Act of 1993 made the trigger trust an ineffective means of planning.

E. TRUSTEES. Choosing a trustee is, without saying, an important decision.

1. Corporate trustee. Texas Property Code §142.005 (creation of a management trust for a minor or incapacitated person by a judge) and Texas Probate Code §867(creation of a management trust for a minor or incapacitated person by a guardian) require the appointment of a corporate trustee except in very limited situations. Therefore, prior to obtaining court approval of either of these two trusts, one should bring the proposed corporate trustee and the beneficiary or the beneficiary's caretakers (parent or spouse) together so that everyone has a clear understanding of beneficiary goals and trustee capabilities.

The beneficiary or if the beneficiary is mentally incapacitated, the beneficiary's family or legal guardian, may be uncomfortable with the appointment of a corporate fiduciary, concerned that while the trustee's policies are presently acceptable, a change of policy could deviate from the grantor's intent. With these concerns, the grantor could consider the appointment of a "Trust Protector."¹⁸⁷ A trust protector is the "guardian angel" watching over the administration of the trust with the power to remove the trustee for any reason and appoint another trustee. One purpose of a trust protector is to give the grantor some measure of assurance that if the trustee does not administer the trust in the way the grantor intended, the offending trustee can be removed and another appointed in its place. The trust protector is not a trustee and has no interest in the trust.¹⁸⁸ Of course, the trust document should clearly define the role of the trust

protector, including language defining the trust protector's liability, if any.¹⁸⁹ In drafting the scope of the trust protector's power, the drafter should take care not to give the trust protector a general power of appointment to avoid the inclusion of the trust corpus in the estate of the trust protector.¹⁹⁰

2. Individual Trustee. Under some circumstances, one might wish to appoint an individual as the trustee of a trust. It is often appropriate to name an adult child the trustee of a testamentary trust for the benefit of a surviving spouse, especially when the trust corpus is relatively small.

Prior to 2001, the Texas Probate Code required the appointment of a corporate trustee when a guardian petitioned the court to create a management trust for the Ward's assets. Effective September 1, 2001, the Code allowed the Court to appoint an individual as the trustee of a management (supplemental needs) trust when (i) the corpus of the trust is less than \$50,000 or (ii) if the corpus of the trust is greater than \$50,000, an individual can be named as the trustee when no corporate trustee will accept the trust.¹⁹¹ As of September 1, 2009, the statute was amended to change the threshold amount from \$50,000 to \$150,000. The Probate Code provision requires the individual trustee to post a bond in the amount of the corpus plus the anticipated annual income of the trust.¹⁹²

Finally, if a parent or a grandparent creates an "A" trust for the benefit of an individual under the age of 65, that parent or grandparent theoretically can name an individual as the trustee. However, the "A" trust is often funded with a personal injury recovery which requires a judicial review of the trust and its terms. In addition to a review of the trust by a judge, there is often an attorney or guardian ad litem appointed for the beneficiary reviewing the trust terms. It may be very difficult to obtain ad litem and court approval of the trust that puts the ward's money in the hands of a parent or other individual. If, for example, an attorney ad litem or guardian ad litem were to recommend a parent serve as trustee of a trust funded with a minor's assets, the ad litem may be risking a subsequent malpractice action brought by an unhappy eighteen year old who discovered that (i) funds had been used for the beneficiary's necessities in abrogation of the parental duty to support,¹⁹³ (ii) funds were improperly invested, or (iii) any number of complaints a disgruntled teen may have against a parent.

3. Beneficiary as trustee. Clearly, a beneficiary should not serve as the trustee of a SNT. Under the major programs outlined in this paper (Medicaid, SSI, etc.), if the beneficiary can control the distribution of the funds, then those funds subject to the beneficiary's control will be deemed to be accessible assets and cause the beneficiary to lose eligibility for benefits.¹⁹⁴

F. TAXING SELF-SETTLED SNT.

1. Grantor or complex trust. One crucial matter that must be addressed when creating any trust is how that trust will be taxed. If the trust is considered a grantor trust, then all of the trust's income, credits and deductions will be treated as if they belonged to the grantor, whether or not the income is distributed. IRC §671. If, on the other hand, the trust is not a grantor trust but a complex trust, then the income is generally taxed by using compressed tax brackets so that, for example, net income in excess of \$10,700 for 2010 will be taxed at a rate of 35%. Because of the complexities of the IRC, the trustee should have some grasp of how the trust will be taxed in order

to explain tape match anomalies to caseworkers.¹⁹⁵ Keep in mind that the Internal Revenue Code definition of income¹⁹⁶ is not the same as the Social Security Administration definition of income¹⁹⁷ or HHSC's definition of income.¹⁹⁸ Therefore, a beneficiary would be well served to have a trustee who can easily explain the differences at the annual review by agency caseworkers.¹⁹⁹

2. Procedural matters. If the grantor's funds are used in creating the trust and the grantor retains certain interests in the trust, then the trust income will be taxed to the grantor.²⁰⁰ The IRC regulations provide two options for reporting income. The trustee can use the grantor social security number to report income or the trustee can obtain a tax identification number for the trust. However, if a tax identification number is obtained for the trust, the trustee must file a 1041 fiduciary income tax return each year reporting under the trust's tax identification numbers. It has been suggested that the following be included on the first page of the return:

“THIS IS AN “INFORMATION ONLY” RETURN. In accordance with Sections 671-678 IRC 1986, all income is taxable to the grantor, social security #

_____.

The trustee should attach statements of income deductions and credits.²⁰¹ The trustee would then send the statements of income, deductions and credits to the beneficiary/grantor to be included on the beneficiary/grantor's form 1040.²⁰² The trustee should keep in mind that the SNT beneficiary or beneficiary's caretaker may be unsophisticated. Even if the trustee has no obligation for the income tax reporting of the beneficiary, the trustee should see that the beneficiary understands that an income tax return must be filed. A letter from the trustee reminding the beneficiary that the beneficiary must file an income tax return is NOT sufficient, in this author's opinion. A better course of action would be for the trustee to offer to assist the beneficiary in engaging an accountant to facilitate the tax reporting. The cost for the accountant could be paid out of the trust assets.

When the trust terminates, the trustee then must file a final form 1041 noting the termination of the trust and final distribution to remaindermen.²⁰³ The trustee will close the trust by forwarding a form K-1 to the remaindermen, and file a form 56 to report the termination of the fiduciary relationship.²⁰⁴ If the trust is terminating because the beneficiary has died, “the final Form 1041 is a complete return, not a flow through return, and includes the final remainder distribution and costs.²⁰⁵ The trustee must keep in mind that once the beneficiary dies, the trust then becomes a complex trust with the unfavorable income tax treatment of compressed tax brackets.²⁰⁶

VI. THIRD PARTY FUNDED STN. Assets belonging to someone other than the beneficiary which are transferred to a supplemental needs trust are not generally counted as an asset for eligibility purposes.²⁰⁷ A third party funded SNT allows a mother to set funds aside for her disabled child or a husband to leave funds for a disabled wife so that when death takes the grantor, the grantor is still able to fund the special care over and above the basics.²⁰⁸ A third party funded SNT does NOT require a reimbursement to the State provision. Therefore, when the disabled beneficiary(s) dies, the remaining trust corpus can be directed to other named beneficiaries or remaindermen.

A. FUNDING THE TRUST

1. Inter vivos gifts. A third party may create and fund a SNT for an individual, with the intent of having the funds used to supplement and not supplant governmental benefits. Inter vivos trusts are often created for family members with tax motives—to reduce the donor’s taxable estate while transferring family assets to intended beneficiaries.

a. For the sole benefit of a disabled person. Under 42 U.S.C. §1396p(c)(2)(B) a person applying for Medicaid benefits may transfer assets, without penalty, “...to a trust established solely for the benefit of, the individual’s child...or to a trust established for the sole benefit of an individual under 65 years of age who is disabled.”²⁰⁹ If the disabled person is receiving governmental benefits, the trust should be a supplemental needs trust. The Texas Administrative Code sets out the determination of whether an asset meets the transfer rules “for the sole benefit” of an individual. “There must be a written instrument of transfer, such as a trust document, which legally binds the parties to a specified course of action and which clearly sets out the conditions under which the transfer was made, as well as who can benefit from the transfer. The instrument or document must provide for the spending of the funds involved for the benefit of the individual on a basis that is actuarially sound based on the life expectancy of the individual involved. When the instrument or document does not so provide, there can be no exemption from the penalty.”²¹⁰

b. Crummey Trust. The trust document for tax planning has often been the “Crummey Trust.” A Crummey Trust creates a present interest in the beneficiary thus effectively removing the asset from the donor’s estate. In order to give the beneficiary a present interest, the beneficiary must have a right to withdraw the present gift.

An example will illustrate the terms of a Crummey Trust and how that trust may also include SNT provisions. Grandmother wishes to gift \$13,000.00 per year to her grandson who is disabled and receiving either SSI and/or Medicaid benefits. The grandmother creates a Crummey Trust with special needs provisions for grandson, giving her grandson the right to withdraw the gift from the trust during a 28 day period from the date of the gift. Under the Medicaid rules, the grandson’s income cannot exceed \$674 or \$2,022 per month, respectively. If he gives away assets he owns, he will be disqualified for monthly benefits by dividing the amount of the gift by \$674 (for SSI cash assistance) or \$130.88 (Medicaid’s daily rate), respectively. If grandmother were to transfer \$13,000.00 into the trust for her grandson and grandson withdraws the funds, he would have disqualifying income in the amount of \$13,000 in the month of receipt and if he still owned the money on the first day of the next month, he would be disqualified because of excess resources. NOT ACCEPTABLE. If grandson did not withdraw the gift of \$13,000.00, the effect would be a transfer of resource to a trust, creating a disqualification period. NOT ACCEPTABLE. However, if grandmother gave the withdrawal right to another person—a remainderman the trust—someone other than grandson, Grandmother’s tax goals would be satisfied and grandson would have a funded without loss of eligibility Language in the trust document that allows a trustee to distribute in-kind exempt assets may also be a way to continue a Crummey²¹¹

c. Insurance SNT. Parents are often concerned about what might happen to their disabled child after the parent dies. Their greatest fear is that the child will be placed in some dark, impersonal warehouse for the disabled when the parents are no longer present to protect the child. Additionally, the parents have only modest assets that would be insufficient to fund the care that the parents would prefer for their child. A counselor should point out to a parent that a SNT could be funded with a life insurance policy, the proceeds of which would be used to continue the child's care after the parents' death. Products such as a "last to die" policy are often the policy of choice, since some carriers will insure both parents with this product even if one parent is individually uninsurable. The parents would gift the annual premium to a trustee each year, filing a gift tax return for the amount of the gift.

d. Finally, a SNT can be used "as a receptacle for charitable gift annuity or charitable remainder trust stream of payments." In Rev. Ruling 2002-20 issued April 29, 2002.²¹² the IRS made it clear that a charitable remainder unitrust (and charitable remainder annuity trust) can pay into an SNT for the benefit of a "financially disabled person" for that person's lifetime. The example given in the ruling was an individual concurrently creates Trust "A," a trust that otherwise qualifies as a charitable remainder unitrust, and a separate trust, Trust "B." Under the trust document of Trust "A," annual unitrust amounts will be paid to trust "B" for the life of "C." "C" is an individual who is financially disabled, that is, "C" is unable to manage his/her own financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months. The ruling sets out 3 situations that will be acceptable by the IRS, two of which are as follows:

Alternative I: Trust "A" charitable remainder unitrust will meet IRS requirements if Trust "A" pays payments into Trust "B" and Trust "B" gives the trustee the absolute discretion to make distributions of income and principal for the financial aid and best interests of "C" in a manner that would supplement but does not supplant any governmental benefits otherwise available to "C." Additionally, upon "C's" death, the balance remaining in Trust "B" will be distributed to "C's" estate.

Alternative II: Trust "A" charitable remainder unitrust will meet IRS requirements if trust "A" pays payments into Trust "B" and Trust "B" gives the trustee the same absolute distributions discretion as previously noted. However, according to this trust "B," upon "C's" death, the state will be reimbursed for the total costs of medical assistance provided to "C" and "C" is given a testamentary general power of appointment, bringing the trust into "C's" estate. If "C" does not exercise the power of appointment, trust "B" could pay over to a relative of "C" and a charity.

2. Testamentary gift. Under Texas law, a legacy vests at the moment of death subject to creditor claims.²¹³ If the decedent created an estate plan that passed a legacy for the benefit of a disabled person to a trustee of a supplemental needs trust, the trust would be a third party trust and would generally cause the trust corpus to be disregarded (or at least possibly disregarded) as a disqualifying asset and there would be no reimbursement to the State requirement. If, however, the Will named the disabled person as the beneficiary, the legacy would vest. While the beneficiary could direct the legacy into an supplemental needs trust, the trust terms must include the reimbursement to the State provision in order to meet the self-settled exception rules.

a. Spousal legacy. A decedent may leave a legacy in a Will for the benefit of a disabled person and protect that disabled person's eligibility for governmental benefits. The most common drafting technique is for a spouse in a nursing home, who is receiving Medicaid long term care benefits ("Applicant"), to transfer all of the Applicant's resources to the spouse living in the community ("community spouse"). Such a transfer between spouses is an allowable transfer. When one spouse qualifies for Medicaid benefits, the Will of the community spouse should be reviewed. Most often, the Will of the community spouse will leave everything to the spouse receiving Medicaid benefits. If the community spouse predeceases the applicant spouse and leaves a countable estate greater than \$2,000.00, the surviving applicant spouse will likely lose Medicaid eligibility until the estate is "spent down." Once the spouse in the nursing home starts receiving Medicaid benefits, the community spouse should revise his/her Will by either leaving the estate to a trustee of a SNT for the benefit of the nursing home spouse. If the SNT met the program criteria, the nursing home spouse would continue to receive benefits and have the advantage of trust distributions to enhance his/her quality of life. In the alternative, the community spouse could disinherit the nursing home spouse, knowing that he/she will be provided for through government programs.²¹⁴ Another example of a testamentary gift is for a parent to leave a legacy to a trustee in a SNT for the benefit of a disabled child.

Beware of disclaiming an inheritance. While under Texas creditor law, a disclaimer is treated as if the person disclaiming predeceased, under the Medicaid and SSI provisions, the disclaimer is treated as a disqualifying transfer.²¹⁵

b. Funding an SNT with an IRA or Qualified Plan.²¹⁶ The reference materials for this portion of the paper are derived from Natalie Choate's book, *Life and Death Planning for Retirement Benefits* and articles written by David Claflin and Eric Viehman. For a thorough treatment of funding a trust with a retirement plan, the author suggests a review of these sources.

More and more individuals are amassing their wealth in sheltered Individual Retirement Account or other Qualified retirement Plans (collectively referred to as a "retirement plan"). These individuals may also wish to use these assets to fund a SNT with such designated funds. However, most retirement plans are funded with pre-tax dollars. Thus, when the dollars are distributed out of the retirement plan, there is a taxable event. To better understand the discussion, the paper will address definitions.

1. Definitions. The following definitions will aid in better understanding the Rules:

(i) “Current Beneficiary means a trust beneficiary who may receive a trust distribution before the trust terminates.”²¹⁷

(ii) “Remainder Beneficiary means a trust beneficiary who will receive some part or all of the termination distribution from a trust.”²¹⁸

(iii) “Countable Beneficiary means a trust beneficiary deemed to be an IRA beneficiary for minimum required distribution”²¹⁹

(iv) “Measuring Beneficiary means the trust beneficiary whose life expectancy determines the required distributions under the minimum required distribution rules.”²²⁰ (i.e. the countable beneficiary having the shortest life expectancy)

(v) “DB testing date means September 30 of the year following the calendar year of the participant’s death.”²²¹

(vi) Designated Beneficiary means a beneficiary who can be identified as an individual.²²² “A ‘designated beneficiary’ is entitled to use the single life table for distributions after death of the participant. The ability to use the Single Life Table will result in the longest possible income tax deferral for the account balance after death of the Participant.”²²³

(vii) MRD means minimum required distribution. These distributions are calculated based on the age of the Designated beneficiary.²²⁴

(viii) RBD means required beginning date for the distribution.

(ix) “Conduit Trust is an informal term for a testamentary trust (designated as beneficiary of a qualified plan) that requires immediate distribution to the beneficiary of all amounts received by the trustee from the qualified plan.... There is no possibility for “accumulation” [or discretion] of undistributed minimum required distributions in the trust.”²²⁵ For general estate planning purposes, a conduit trust with an individual as the designated beneficiary is the trust of choice because the IRS is certain that the proper amount of minimum required distributions are being made to the identifiable individual.

(x) “Accumulation Trust is an informal designation for a trust that could accumulate distributions from qualified. The possibility of such accumulation could result from trustee discretion regarding distributions or from trust definitions of principal and income.”²²⁶ The problem that arises with an accumulation trust is that “distributions accumulated in a trust may, in the future, be distributed to a non-individual beneficiary or a beneficiary who is

older than the one whose life expectancy is used to determine MRD.”²²⁷ Therefore, in an accumulation trust, the countable beneficiaries will include the remainder beneficiaries to the trust.²²⁸

(xi) Ghost life expectancy means basing minimum required distributions on the theoretical life expectancy of the deceased plan participant based on the age in the year of death.²²⁹ “This life expectancy is reduced by 1 for each post-death calendar year to determine the minimum required distribution for such years.”²³⁰

2. The Trust Rules. There are strict rules on the payment of retirement plans to persons designated as beneficiary. The Regulations “generally require that retirement benefits be entirely distributed out of the plan (and subjected to income tax) within five years after the Participant’s death (if he died before his required beginning date), or over what would have been the remaining single life expectancy of the deceased participant (if he died on or after his RBD). However, if the benefits are left to an individual (human) beneficiary, or to a qualifying trust, the benefits can be distributed, instead, in annual installments over the individual beneficiary’s life expectancy (or over the life expectancy of the oldest beneficiary of the trust).”²³¹ Under the rules adopted by the Internal Revenue Service in February 2002:

“A trust will qualify as a Designated Beneficiary under the Final Regulations provided that:

(a) the trust is valid under state law, or would be except that it has no assets until the death of the participant

(b) the trust is irrevocable upon the death of the participant;

(c) the beneficiaries of the trust are individuals (e.g., a charitable split-interest trust will not qualify) and are identifiable pursuant to the terms of the trust;

*(d) the required documentation is provided to the plan administrator.”*²³²

The requirements for trust beneficiaries to meet the regulation requirements as a designated beneficiary of a retirement plan may appear on its face to be simple--but the complications arise with subparagraph “(c).”

Because a Conduit trust requires a pass-through of the MRD amount, a Conduit trust would be impractical as a SNT. The pass-through distribution would almost necessarily cause the beneficiary to receive disqualifying income. Therefore, in order to fund a SNT with a retirement plan, the SNT will be an accumulation trust. The problems with an accumulation trust is in determining (1) that all of the beneficiaries are individuals and (2) the age of the oldest beneficiary on which to calculate the MRD amount.

For example, assume that the Plan beneficiary died at age 72 after minimum required distributions had begun. The Plan beneficiary named a testamentary trust for the benefit of his 30 year old son as the beneficiary of the retirement plan, with the trust to terminate at the son’s age 50. If the son does not live to age 50, the trust is to terminate and pay over to the son’s estate. If the plan administrator makes minimum required distributions based on the son’s age 30 (which in this case,

is significantly under the MRD), there is a 50% penalty that would apply to each under-distribution.²³³ The reason that the penalty would be assessed is that an estate is not an individual thus violating provision “(c)” requirement of the rule. The MRD should have been calculated, in this case, on the Ghost life of the Plan Participant. Other pitfalls are naming remainder beneficiaries who are the descendants of the plan participant and adopted children are included in the definition of descendants.²³⁴ A wise course of action for a trustee would be to make distributions out of an accumulation trust according to the default rules of 5 years or the Ghost life of the Plan participant or to obtain a private letter ruling from the Internal Revenue

B. SUBROGATION. There is no subrogation when funding third party SNTs. Since the assets funding the trust do not belong to the applicant, there is no subrogation.

C. TRUSTEES.

1. Corporate Trustee. When creating a third party funded SNT, the grantor may want to name a family member to save the expense of paying a trustee. The grantor instructs the attorney to name a sibling as the trustee of a SNT. However, the grantor should consider whether or not sibling rivalry or other family issues may cause conflict between the trustee and the beneficiary. By appointing a corporate trustee, the sibling can be the supportive sister or brother rather than appearing to take on the role of parent.

Of course, the grantor may still be uncomfortable with the appointment of a corporate fiduciary, concerned that while the trustee’s policies are presently acceptable, a change of policy could deviate from the grantor’s intent. With these concerns, the grantor could consider the appointment of a **TRUST PROTECTOR**.²³⁵ A trust protector is the “guardian angel” watching over the administration of the trust with the power to remove the trustee for any reason and appoint another trustee. One purpose of a trust protector is to give the grantor some measure of assurance that if the trustee does not administer the trust in the way the grantor intended, the offending trustee can be removed and another appointed in its place. The trust protector is not a trustee and has no interest in the trust.²³⁶ Of course, the trust document should clearly define the role of the trust protector, including language defining the trust protector’s liability, if any.²³⁷ In drafting the scope of the trust protector’s power, the drafter should take care not to give the trust protector a general power of appointment to avoid the inclusion of the trust corpus in the estate of the trust protector.²³⁸

2. Individual trustee. Under some circumstances, one might wish to appoint an individual as the trustee of a trust. It is often appropriate to name an adult child the trustee of a testamentary trust for the benefit of a surviving spouse, especially when the trust corpus is relatively small. However, the grantor should take into consideration, the maturity, education, availability, financial and emotional burden, personality issues and personal needs of any individual named as trustee of an SNT. To this end, the grantor should discuss the trust and his/her intentions with the proposed trustee to verify that the individual is willing and able to serve in such capacity. Again, clearly, a beneficiary should not serve as the trustee of a SNT. Under the major programs outlined in this paper (Medicaid, SSI, etc.), if the beneficiary can control the distribution of the funds, then those funds subject to the beneficiary’s control will be deemed to be accessible assets and cause the beneficiary to lose eligibility for benefits.²³⁹

D. TAXING THIRD PARTY SNT. One crucial matter that must be addressed when creating any trust is how that trust will be taxed. If the trust is considered a grantor trust, then all of the trust's income, credits and deductions will be treated as if they belonged to the grantor, whether or not the income is distributed. IRC §671. If, on the other hand, the trust is not a grantor trust but a complex trust, then the income is generally taxed by using compressed tax brackets so that, for example, net income in excess of \$10,700 for 2010 will be taxed at a rate of 35%. Because of the complexities of the IRC, the trustee should have some grasp of how the trust will be taxed in order to explain tape match anomalies to caseworkers.²⁴⁰ Keep in mind that the Internal Revenue Code definition of income²⁴¹ is not the same as the Social Security Administration definition of income²⁴² or the HHSC definition of income.²⁴³ Therefore, a beneficiary would be well served to have a trustee who can easily explain the differences at the annual review by agency caseworkers.²⁴⁴

1. Complex trust. If the trust is funded with funds arising from any other source, other than the beneficiary, then the trust is a non-grantor trust and is taxed as a "complex trust."²⁴⁵ "Complex trusts are taxed by using compressed tax brackets so that, as previously noted, when the net taxable income exceeds \$10,7000 for 2010, the tax rate is 35%."²⁴⁶ A trustee must file an annual form 1041 on behalf of the trust, reporting any income and allowable deductions.²⁴⁷ The trustee will also forward a K-1 to beneficiaries reporting any net income that was distributed.²⁴⁸

2. Grantor status for tax purpose in third party funded SNT. The taxing of a third party SNT is discussed in a subsequent section of this paper. However, grantor status of a third party funded trust could be useful. "While the income can be paid for the benefit of the disabled person, the grantor will be paying the tax on that income. This has the effect of reducing the size of grantor's gross taxable estate without the payment of income tax being treated as a gift for the benefit of the disabled person. The net result is, as a practice matter, the same as if the disabled person received a gift from the grantor in order to pay the income tax, if any."

VII. CONCLUSION. Just a reminder. Drafting a special needs trust is not a "form" practice. Program eligibility requirements must be evaluated, needs of the beneficiary, location and future locations of the beneficiary, trustees and a myriad of other issues. Therefore, understand that a good SNT form is only a starting point on which to build a valuable estate plan.

*** THIS PAPER WAS ORIGINALLY WRITTEN BY PATTY SITCHLER AROUND 2006. IT WAS UP-DATED BY MOLLY ABSHIRE IN 2007 AND BY RANDY DREWETT IN 2008 AND 2010. MANY THANKS TO PATTY AND MOLLY FOR ALLOWING ME TO USE THIS EXCELLENT PAPER FOR THIS COURSE.**

ENDNOTES

1. 42 U.S.C. §1396p.
2. Other resources that provide excellent explanation of SNTs and their uses are (in alphabetical order by author): H. Clyde Farrell, *Public Benefits for Texans with Disabilities*, Intermediate Estate Planning Guardianship and Elder Law Conference, The University of Texas School of Law, Galveston, August 16-17, 2001; Deborah A. Green & Shannon Holub, *Planning to Protect Government Benefits Using Trusts & Estate Planning*, Intermediate Estate Planning, Guardianship

& Elder Law Conference, The University of Texas School of Law, August 26-27, 1999; Clifton B. Kruse, Jr., *Third Party and Self-Created Trust: Planning for the Elderly and the Disabled Client* (2nd ed.) Chicago, IL: ABA Real Property, Probate and Trust Law Section, 1998; Renee Colwill Lovelace, *Special Needs Trusts 2001 Update, Expanded Uses and Markets*, Intermediate Estate Planning, Guardianship and Elder Law Conference, The University of Texas School of Law, Galveston, Texas, August 16-17, 2001. There are numerous CLE articles which are included in the materials for the UT CLE Special Needs Trust Course, the State Bar of Texas Advanced Elder Law Course and the Stetson University College of Law Special Needs Trust National Conference each year. Clyde Farrell's treatise is updated every year.

3. H. Clyde Farrell also discusses trust provisions that allow a trustee to make distributions under the one-third reduction rule or the presumed maximum value rule in *The Big Four: Supplemental Security Income, Social Security Disability, Medicare & Medicaid*, Intermediate Estate Planning, Guardianship and Elder Law Conference, August 17 and 18, 2000, Galveston, Texas, p.5-6.
4. *Sanders v. Pilley*, 684 So.2d 460, 464 (La. 1st Cir. 1996) writ denied, 691 So.2d 90 (La. 1997), citing to *Atkins v. Rivera*, 477 U.S. 154, 156, 106 S.Ct. 2456, 2458, 91 L.Ed.2d 131 (1986).
5. See Clifton B. Kruse, Jr., *Medicaid Trusts*, 19th Annual Advanced Estate Planning And Probate Course, State Bar of Texas, June 1995, p.K-1. See, for example, *Vanderbilt Credit Corp. v. Chase Manhattan Bank*, 473 N.Y.S.2d 242, 246 (A.D. 1984).
6. See, for example, *Kegel v. State*, 113 N.M. 646, 649, 830 P. 2d 563, 566 (1992) holding that a personal injury award that was directed by a guardian pursuant to court order were not funds belonging to the individual beneficiary.
7. Public Law 99-272 §9506(a)
8. Adding 42 U.S.C. §1396(a)(k). See also, State Medicaid Manual, §3215.1, defining Medicaid Qualifying Trust. http://www.cms.gov/manuals/45_smm/sm_03_3_toc.asp.
9. The text of the MQT statute is as follows:
PL. 99-272 §9506(a) Treatment of Potential Payments from a Medicaid Qualifying Trust, enacted April 7, 1986

(a) Amounts treated as being available from a Grantor Trust; §1902 of the Social Security act (42 U.S.C. 1396(a)) is amended by adding at the end thereof the following new subsection.

(k)(1) In the case of a medicaid qualifying trust (described in paragraph (2)), the amounts from the trust deemed available to a grantor ... is the maximum amount of payments that may be permitted under the terms of the trust to be distributed to the grantor, assuming the full exercise of discretion by the trustee or trustees for the distribution of the maximum amount to the grantor. For purpose of the previous sentence, the term grantor means the individual referred to in paragraph (2).

(2) For purposes of this subsection, a "medicaid qualifying trust" is a trust, or similar legal devise, established (other than by will) by an individual (or an individual's spouse) under which the individual may be the beneficiary of all or part of the payments from the trust and the distribution of such payments is determined by one or more trustees who are permitted to exercise any discretion with respect to the distribution to the individual.

(3) This subsection shall apply without regard to

(A) whether or not the medicaid qualifying trust is irrevocable or is established for purposes other than to enable a grantor to qualify for medical assistance under this title or

(B) whether or not the discretion described in paragraph (2) is actually exercised.

(4) The state may waive the application of this subsection with respect to an individual where the state determines that such application would work an undue hardship.

(b) Effective Date: The amendment made by subsection (a) shall apply to medical assistance furnished on or after the first day of the second month beginning after the date of the enactment of this act.

10. *Id.*

11. *Id.*

12. *See, for example, Kegel v. State*, 113 N.M. 646, 649, 830 P. 2d 563, 566 (1992) holding that a personal injury award that was directed by a guardian pursuant to court order were not funds belonging to the individual beneficiary. “The only kind of trust to which §1396(a)(k)(2) expressly extends is one created by the beneficiary or the beneficiary’s spouse.... States may not create an exclusion from eligibility for receipt of public assistance benefits unless federal law clearly authorizes it. *See e.g. Phillbrook v. Glodgett*, 421 U.S. 707, 719, 95 S. Ct. 1893, 1901, 44 L. Ed. 2d 525 (1975).

13. A limited partnership is defined in the Texas Administrative Code as being a device similar to a trust and should be treated accordingly. 1 T.A.C. §358.417

14. PL 103-66 (HR 2264), referred to as the Omnibus Budget Reconciliation Act of 1993 (OBRA ‘93) repealing 42 U.S.C. §1396(a) and enacting in its place, 42 U.S.C. §1396p. *See also*, State Medicaid Manual, §3259, found at http://www.cms.gov/manuals/45_smm/sm_03_3_toc.asp.

15. 42 U.S.C. §1396p(d)(4)(A); State Medicaid Manual, §3215.2, found at http://www.cms.gov/manuals/45_smm/sm_03_3_toc.asp; 1 T.A.C. §358.417.

16. 42 U.S.C. §1396p(d)(4)(B); State Medicaid Manual, §3215.2, found at http://www.cms.gov/manuals/45_smm/sm_03_3_toc.asp; 1 T.A.C. §358.417.

17. 42 U.S.C. §1396p(d)(4)(C); State Medicaid Manual, §3215.2, found at http://www.cms.gov/manuals/45_smm/sm_03_3_toc.asp; 1 T.A.C. §358.417.

18. POMS Sections Affected: SI 01120.200 FILE NO: EM-00067, date: May 26, 2000.

19. See a related article by Terry M. Magady, *The Use of Standardized Forms when Drafting Special needs Trusts is not always the Best Means of Addressing the Particular Needs of the Disabled*, Los Angeles Lawyer, February 2002.

20. In 2001, of the 2,656,682 million persons receiving some type of Medicaid benefit, 97,389, or less than 4% of those beneficiaries, were receiving nursing home benefits. www.cms.hhs.gov/medicaid/msis/01tx.pdf, Table 4, *Medicaid Beneficiaries by Type of Service*. The cost of benefits for those 4% of the Medicaid beneficiaries receiving Medicaid long term care nursing home benefits in 2001 was 16% of the total Medicaid payments or \$1,605 billion dollars. *Id.*

21. 42 U.S.C.A. §1396p.

22. The Medicaid Eligibility Handbook can now be accessed online at www.dads.state.tx/handbooks/mepd.

23. 1 T.A.C. §358.100 (104).

24. Texas Medicaid Eligibility Handbook, §F-1300.
25. *Id.*
26. 42 U.S.C. §1396r-5 ; *see also*, 1 T.A.C. §358.503.
27. One should keep in mind that a premarital or antemarital agreement is not binding for medicaid eligibility.
28. 1 T.A.C. §358.441(a)(2). If the Applicant does not have a spouse who will live in the home, then there is the issue of how the home can be maintained while the Applicant lives in the nursing home. The easiest solution for this situation is to have a family member live in the home, paying the utilities, insurance, taxes directly to the provider. Additionally, the family member would make any minor repairs to the property. As long as there is no agreement to pay with the Applicant, the Applicant should not have "deemed" income.

Often though, there is no "trusted" relative who can move into the house to maintain it. Then there may be a necessity to enter into a rental contract in order to put someone in the home. According to new DHS rules, effective July 1, 1997, if the Applicant or the Applicant's agent signs a rental agreement with a third party, then any payments are generally countable income to the Applicant. However, there are certain deductible expenses from the countable income. In general, the deductible expenses are: real estate insurance (except for liability insurance), repairs (minor correction to an existing structure) property taxes, lawn care, realtor costs, advertising for tenants & utilities. Therefore, if the rental agreement called for payment directly to the provider of only deductible expenses, then I suggest that any "deemed" income to the Applicant would be offset by a deductible expense and the house would be preserved.

The matter becomes more complicated when there is a mortgage involved. The rules regarding Mortgage Payments Made By a Third Party provide: "(1) If the client's homestead is vacant and a third party is making client's mortgage payments using his (the third party's) own funds, these payments are NOT income to the client [generally these payments are made by a close relative to preserve the property]. (2) If the client's home is rented and the lease agreement specifies that the tenant pays the client's mortgage company in lieu of rent, these payments are countable income to the client and are treated as rental income. (3) If the client's home is rented and there is no lease agreement, voluntary payments of the client's mortgage by the tenant directly to the mortgage company are considered to be a "gift" to the client and are countable income."

29. 1 T.A.C. §358.441(b)(6)(A),(B). A burial space is defined as "a burial plot, grave site, crypt, mausoleum, urn, casket, niche, or other repository customarily and traditionally used for the deceased bodily remains." The term also includes necessary and reasonable improvements or additions to these spaces, including, but not limited to values, headstones, markers or plaques; burial containers; arrangements for opening and closing of grave site; and contracts for care and maintenance of the grave site. Contracts for care and maintenance are sometimes referred to as endowment or perpetual care. 1 T.A.C. §358.100 (17)
30. 1 T.A.C. §358.442(d).

31. 1 T.A.C. §358.442(e).
32. 1 T.A.C. §358.435(h) .
33. 1 T.A.C. §358.442(a). See Appendix V; policy clarifications.
34. 1 T.A.C. §358.442(b). See Appendix V; policy clarifications.
35. 1 T.A.C. §358.442(c).
36. 1 T.A.C. §358.442(f).
37. 1 T.A.C. §358.443(a).
38. 1 T.A.C. §358.443(a)(3). This property is generally a mineral interest. The value of a mineral interest can be calculated by multiplying 40 time the average monthly income.
39. See 1 T.A.C. §358.431 *et seq.* If a transfer is exclusively for a purpose other than to qualify for Medicaid, then the transfer should not be a disqualifying event." H.C.F.A. State Medicaid Manual, §3258.10.C. Appendix II. Additionally, "there are a number of instances (*i.e.*, exceptions) where, even if an asset is transferred for less than fair market value, the [disqualifying transfer] penalties do not apply." H.C.F.A. State Medicaid Manual, §3258.10. Appendix II. For example, assets transferred to the individual's spouse or to another for the sole benefit of the individual's spouse is an exception to the transfer rules. *Id.* Allowable transfers will be discussed in Article IV.A.2., *infra*.
40. 42 U.S.C.A. § 1396p(c)(1)(B). See also, H.C.F.A. State Medicaid Manual, §3258.4.D. Appendix II.
41. *Id.*
42. H.C.F.A. State Medicaid Manual, §3258.5.
43. *Id.*
44. *Id.*
45. H.C.F.A. State Medicaid Manual, §3258.10.C.5.
46. 42 U.S.C. §1396r-5(b)(1).
47. 42 U.S.C. §1396r-5(b)(2). See also, H. Clyde Farrell and Pi-Yi Mayo, *Elder Law and Medicaid Issues in Texas*, p. 114-15 (1995).
48. Husband's income would exceed \$2,022.00 income cap set for 2009-2011 in Texas.
49. *Miller v. Ibarra*, 746 F.Supp. 19 (D.Colo. 1990).

50. 42 U.S.C. §1396p(d)(4)(B).
51. See Appendix I.
52. The DHS allows a deduction from "applied income" for guardian fees which is the amount of fees set by the court. Applied income is that amount of personal income a nursing home resident client must pay to the facility toward his cost of care. 1 T.A.C. §358.100 (9).
53. Texas Medicaid Eligibility Handbook §H-1000; See also, *Rudow v. Com. of the Division of Medical Assistance*, 707 N.E. 2d 339 (Mass. 1999)(holding that guardianship costs were necessary medical and remedial care expenses for recipients, which could be deducted from their incomes for purposes of determining the applied income.)
54. H.C.F.A. State Medicaid Manual, §3259.7.B.5. H.C.F.A. was the Health Care Finance Administration. Effective 2001, the name has changed to the Center for Medicare and Medicaid Services–CMS.
55. See Texas Medicaid Eligibility Handbook, Appendix XXXVI.
56. See Note 59, *supra*.
57. See Note 59, *supra*, for the definition of "applied income."
58. H.C.F.A. State Medicaid Manual, §3259.7.B.5.
59. 1 T.A.C. §358.300(a),(b).
60. 1 T.A.C. §358.301(a).
61. 1 T.A.C. §358.305(a). Disability is defined pursuant to the Social Security Act as found in 42 U.S.C. §1382c(a)(3)(A) as follows: "An individual shall be considered to be disabled for purposes of this subchapter if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity).
62. 1 T.A.C. §358.315.
63. 1 T.A.C. §358.417(d)(1).
64. 1 T.A.C. §358.417.
65. 1 T.A.C. §358.415(h)(1).
66. 1 T.A.C. §358.415(h)(1).
67. A supplemental or special needs trust is a trust for supplemental or special needs. The client should understand that generally, a supplemental needs trust does not pay for necessities – food and

shelter– nor does it generally allow for distributions of cash, IF those distributions would disqualify the individual for governmental benefits. Note that as of March 9, 2005, SSI eliminated “clothing” from its definition of in-kind income.

Payments directly to the provider for the special or supplemental needs of an individual could be for such items or services as follows:

- (i) Prepayment of cable TV if paid directly to the provider;
- (ii) Payment directly to the provider for hair care;
- (iii) Extra pair(s) of glasses;
- (iv) Bedspreads, knick knacks, hobby items, framed photos, pictures, plants, rocking chair;
- (v) TV, radio, VCR, tape recorder and books on audio tapes;
- (vi) Club or hobby memberships and magazines;
- (vii) Massage therapists;
- (viii) Psychologists, psychiatrists, counselors, therapists and dental care not provided by Medicare or Medicaid;
- (ix) Skilled care such as occupational, speech, music or physical therapists that are not covered by Medicare or Medicaid;
- (x) Fresh flower delivery--especially for holidays;
- (xi) Alternative medical care--acupuncture, hypnosis, and relaxation therapies.
- (xii) Trips and travel. If the applicant could not travel then the Trustee could send for friends or relatives and pay for their trip to visit him. (Any airline tickets must NOT be refundable to the traveler and must be returned to the Trustee.)
- (xiii) Pet care. The trustee could pay for animal supplies and vet bills.

See Regan & Gilfix, Tax, Estate and Financial Planning for the Elderly, Forms and Practice, (Matthew Bender) §I:19[5], pp. 124-125 (2001).

Disqualifying distributions would include payment of the food, rent, mortgage payments, real property taxes, heating fuel, gas, electricity, water, sewage, and garbage collection services. 20 C.F.R. §416.1130(b).

- 68. Each of the "self-settled" trusts described in this section have been fashioned to allow an individual to put his own money into a trust and immediately qualify for Medicaid IF the trust provides, among other things, that **on the death of the beneficiary**, the State will be reimbursed from the remaining assets in the trust. The unsettled question that arises is what happens if the trust should terminate for some reason prior to the beneficiary's death? To the writer's knowledge, this issue has not been specifically addressed in Texas.
- 69. Disability is defined under the requirements for Social Security Disability Insurance benefits ("SSDI") or SSI benefits. See Note 68 *supra* for the definition of "disability."
- 70. 42 U.S.C.A. §1396p(d)(4)(A).
- 71. An individual must be very careful in disclaiming an interest in an estate in order to preserve Medicaid eligibility. While Texas law and Internal Revenue Code generally treat a disclaimer as if the person predeceased the testator, federal Medicaid laws and state regulations do not. If a person disclaims an interest prior to its vesting, there is no disqualifying penalty. However, DHS considers vesting on the death of the testator. Thus, if an applicant disclaims property

after the death of a testator, the DHS will consider the disclaimer a disqualifying transfer of assets. 1 T.A.C. §358.430(c)(1).

72. 42 U.S.C.A. §1396p(d)(4)(C).
73. 42 U.S.C.A. §1396p(d)(4)(C).
74. The Arc of Texas Master Pooled Trust has four specific trusts available for funding: Trust I is a third party trust with very strict distribution terms; Trust II is a self-settled trust with very strict distribution terms; Trust III is a third party trust with broad discretionary distribution rules that includes discretionary support distributions; and Trust IV is a self-settled trust with similar broad discretionary distribution rules.
75. The Center for Medicare and Medicaid Services is the successor to HCFA, the Health Care Finance Administration. The transfer penalty arising from State Medicaid Manual, §3259.7B, see Appendix II.
76. State Medicaid Manual, §3259.
77. Texas Medicaid Eligibility Handbook, §F-6000.
78. 42 U.S.C. §1396p (a) & (b).
79. 1 T.A.C. §373.103.
80. MEH Policy Clarification dated 9/29/05. The policy clarification refers to a daily rate to determine any period of disqualification. However, neither the federal law nor state regulations refer to a daily divisor. Both the federal law and state regulations refer to a monthly divisor. There is the possibility that several days of additional penalty if a daily rate is used. The Texas Chapter of the National Academy of Elder Law Attorneys formally notified the state of this discrepancy. To date, there has been no change of policy but, informally, the agency representatives have stated that if the issue is raised, the state will apply the more accurate calculation. The problem is that the issue must be pointed out to have the proper application of the law.
81. SSI should be distinguished from other Social Security benefits such as Social Security (retirement) income, Social Security Survivor benefit paid to a disabled child of a deceased eligible worker, and Social Security Disability Insurance paid to a disabled worker who has contributed to the Social Security fund through employment contributions. Title 42 of the United States Code.
82. POMS can now be accessed on the internet at www.ssa.gov. The question arises as to whether or not POMS carries the force of law. In the mid 90's there were differing opinions as to whether POMS carried any force of law. A case out of California has held that POMS is designed solely for the internal use of the Social Security Administration and thus, has no force of law. *Ziff v. Chater*, 930 F. Supp. 1356 (N.D. Cal. 1996). On the other hand, a court in Florida remanded a case when the administrative law judge failed to follow POMS. *Sabo v. Chater*, 955 F. Supp. 1456 (M.D. Fla 1996). In *Christensen v Harris County*, 529 U.S. 576, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) the United States Supreme Court held that "Interpretations such as those in opinion letters--like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law"... only warrant respect.

83. The portion of the Act regulating transfers was effective December 14, 1999 and the portion of the Act setting out the trust rules was effective January 1, 2000.
84. Regan, Morgan & English, *Tax, Estate & Financial Planning for the Elderly*, Matthew-Bender & Company, Inc. 2001, §8.15[2], p.8-49 citing to 42 U.S.C. §1382b(c)(1)(A).
85. Regan, Morgan & English, *Tax, Estate & Financial Planning for the Elderly*, Matthew-Bender & Company, Inc. 2001, §8.15[2], p.8-49.
86. POMS SI 1310.001.
87. *Id.*
88. *Id.*
89. The first \$20.00 of income is disregarded.
90. Social Security Administration (“SSA”) published proposed changes to SSI rules in the *Federal Register*, January 6, 2004 (Volume 69, Number 3) and adopted the changed in *Federal Register*, February 7 (Volume 70, Number 24). One of the changes is to eliminate clothing from the definition of income. Presently, income includes receipt of “food, clothing and shelter.” As a result of the rule change, receipt of clothing will no longer be considered income. Thus, distributions for clothing and payment of credit card bills for clothing would no longer be a disqualifying distribution.
91. 20 C.F.R. §416.1103.
92. 42 U.S.C. §1382a(a); 20 C.F.R. §§416.1102, 416.1110, 416.1112. There are certain exceptions to earned income such as \$10 of infrequent income, other federal assistance programs and the first \$65.00 of earned income.
93. 42 U.S.C. §1382a(a)(2); 20 C.F.R. § 416.1120. For example, unearned income includes pensions, annuities, support or alimony, gifts, prizes or a legacy, just to name a few categories. The regulations also include exclusions from unearned income such as \$20 of infrequent income, a portion of child support payments and certain VA benefits, to name a few. 42 U.S.C. §1382a(b); 20 C.F.R. §416.1124.
94. 20 C.F.R. §416.1123.
95. 20 C.F.R. §416.1111.
96. 20 C.F.R. §416.1131; POMS SI 00835.200
97. *See Hickman v. Bowen*, 803 F.2d 1377 (5th Cir. 1986) no writ (Court held that in-kind maintenance and support is not limited to cash and could include a loan of rent and board).
98. 20 C.F.R. §416.1141; POMS SI 00835.300
99. POMS SI 00835.300.
100. POMS SI 01320.150.
101. POMS SI 00835.210.

102. POMS SI 00501.001.
103. Regan, Morgan & English, *Tax, Estate & Financial Planning for the Elderly*, Matthew-Bender&Company, Inc. 2001, §8.15[2], p.8-50.
104. POMS SI 01120.200 B. 13.
105. POMS SI 01120.200.
106. POMS SI 01120.201.
107. Texas Health & Safety Code §534.0175
108. Texas Health & Safety Code §552.018
109. Texas Health & Safety Code §593.081
110. Client: Texas Health & Safety Code §§534.017; 25 T.A.C. §412.105-106 as published in 26 Tex. Reg. 10765, December 28, 2001, 2001 WL 1669480 (Tex.Reg), adopted March 15, 2002, in 27 Tex. Reg. 2041, 2002 WL 423232 (Tex.Reg.)
- Patient: Texas Health & Safety Code §§552.016-017; 25 T.A.C. §417.104 as published in 25 Tex.Reg. 1109, 2000 WL 174731 (Tex.Reg.)
- Resident: Texas Health & Safety Code §§593.011, 593.075 & 593.078; 25 T.A.C. §417.104 as published in 25 Tex.Reg. 1109, 2000 WL 174731 (Tex.Reg.)
111. *Id.*
112. The two Texas cases that address state recovery for benefits paid for a trust beneficiary are: *California Dept. of Mental Hygiene v. Bank of Southwest Natl. Assn.*, 163 Tex. 314, 354 S.W.2d 576 (1962)(Trust instructed trustee to make fixed monthly payments for institutionalized beneficiary unless a lesser or greater amount was needed. The Court held that once the state hospital notified the trustee of increased payment, the trustee was required to pay the greater cost.). *State v. Rubion*, 158 Tex.43, 308 S.W.2d 4 (1957)(Trust was deemed a “support” trust and thus the trustee must reimburse the state for the support of a beneficiary residing in a state hospital. The court limited the state’s recovery to only those amounts that the beneficiary could have forced the trustee to pay.)
113. Renee Lovelace’s article *Special Needs Trusts 2001 Update, Expanded Uses and Markets*, discusses a nationwide effort to standardize a SNT. This model trust is referred to in her paper as the gold standard trust. The model trust arose as a result of the “chaos and uncertainty in drafting SNTs” with the hope of creating a “model” SNT that would be acceptable through out the U.S. As of this date, there is no Model SNT acceptable in all or even a majority of states. *Intermediate Estate Planning, Guardianship and Elder Law*, The University of Texas School of Law, Galveston, Texas, August 16-17, 2001, pp. 35-36.
114. A copy of Trust II can be obtained from the Arc of Texas website, www.thearcoftexas.org.

115. Prior to March 9, 2005, clothing was considered in-kind income and so drafters of strict SNTs may have included language that prohibited distributions for clothing. If the language of the trust specifically prohibits distributions for clothing, the trustee may consider obtaining a judicial modification of the trust to utilize the newly acquired ability to make distributions for clothing.
116. A copy of Trust IV can be obtained by requesting a copy from the Arc of Texas via their website www.thearcoftexas.org.
117. See one-third reduction rule and presumed value rule discussion, *infra*.
118. See H. Clyde Farrell, *The Big Four: Supplemental Security Income, Social Security Disability, Medicare & Medicaid*, Intermediate Estate Planning, Guardianship and Elder Law Conference, The University of Texas School of Law, Galveston, Texas, August 17-18, 2000. Mr. Farrell's paper contains example trust provisions that are helpful in drafting a SNT.
119. See *Metz v. Ohio Dept. of Human Services*, 762 N.E.1032 (Ohio App. 6 Dist. 2001, no writ). In *Carnahan v. Ohio Dept. of Human Services*, "Funds were available 'where the cotrustees had the sole and absolute discretion of making disbursements that were necessary for the beneficiary's care, comfort, maintenance and general well-being.' But funds were not available where 'the trustee was given absolute discretion to make disbursements to maintain appellee's good health, safety and welfare but only when such requisites were not being provided by a public agency, office or department of any state or of the United States.'" 743 N.E.2d 473 (Ohio App. 11th Dist. 2000). Additionally, The Texas Department of Mental Health and Mental Retardation, has in the past, generally required supplemental needs language to protect a person's eligibility for MHMR benefits.
120. Information about the Texas Health Pool can be obtained from www.txhealthpool.com. The premium for coverage is generally 165% of the standard rate for individuals.
121. Before distributions are made, certain procedural matters must be completed by the trust officer. For example, a trust company is regulated by Office of the Comptroller, a state regulatory agency that can audit trust companies at their discretion. There are internal auditors within a trust company who audit to see that there is appropriate and complete documentation in each file; audit investment objectives and allocations; audit to confirm that the investment has been implemented; and verify that the file contains such documentation such as a birth certificate, copy of the social security card and a signed W-9. If the internal auditor does not find a complete file, the trust officer will be "written up" on an exception list. Additionally if the state auditor finds deficiencies, the trust company could potentially lose its state charter. Therefore, being mindful of these housekeeping matters will certainly make the administration of the trust more efficient.
122. See SI 01120.200e.1.B.
123. See SI 01120.200F
124. 20 C.F.R. §416.1130(b).
125. See *Hickman v. Bowen*, 803 F.2d 1377 (5th Cir. 1986) no writ (Court held that in-kind maintenance and support is not limited to cash and could include a loan of rent and board).
126. 40 T.A.C. §15.455(b)(1).
127. See Texas Constitution, Art. 8, §1(b) and §2. Texas Tax Code §11.22 allows for an exemption from some property tax to a disabled veteran and the deceased veteran's surviving spouse.

128. May 25, 2004, policy clarifications issued by Texas Department of Human Services.
129. *See* POMS SI 01130.500 and .501.
130. Texas Family Code Chapter 151.001; Texas Probate Code §777.
131. Texas Probate Code §777.
132. *Calef v. Barnhart*, 309 F. Supp.2d 425 (E.D. New York) March 24, 2004.
133. *Calef v. Barnhart*, 309 F. Supp.2d 425, 432 (E.D. New York) March 24, 2004.
134. *Calef v. Barnhart*, 309 F. Supp.2d 425, 432 (E.D. New York) March 24, 2004.
135. *See* POMS SI 00815.001.
136. POMS SI 00815.350.
137. *In an Irrevocable Supplemental Needs Trust of Jennifer Collins* (Minn. Ct. App. No. A04-1018, December 14, 2004, *unpublished opinion*). For the Texas law, *see* Texas Guardianship Code §871 requiring the trustee of a trust created by a guardian to account to the court on an annual basis for approval “in the same manner that is required of an annual account prepared by a guardian...”
138. *Id.* at p.5.
139. Renee Colwill Lovelace, *Special Needs Trusts 2001 Update, Expanded Uses and Markets*, Intermediate Estate Planning, Guardianship and Elder Law Conference, The University of Texas School Of Law, August 16-17, 2001, p.29.
140. *Id.* at 19. For a listing of local care coordinators, call the National Association of Geriatric Care Managers at (520) 881.8008 or through their website at www.caremanager.org. *Id.*
141. H. Clyde Farrell has recommended such a trust provision in his article *The Big Four: Supplemental Security Income, Social Security Disability, Medicare and Medicaid*, Intermediate Estate Planning, Guardianship and Elder Law Conference, The University of Texas School of Law, Galveston, Texas, August 17-18, 2000, p.82.
142. Texas Probate Code §873(2)(C); Texas Property Code §142.005(e).
143. 2004 WL 542531 (N.D. Illinois) March 10, 2004.
144. 42 U.S.C. § 1396(e)(1). The federal statute extends the definition of assets to include those assets arising from a personal injury recovery or a legacy or inheritance. *Id.* *See also*, POMS SI 01120.200 *et seq.* (TDHS adopting POMS). *See* the discussion of MHMR Trust exception rules for a discussion of self-settled trusts that are considered resources.
145. *See* Section III.A.4, *supra*.
146. While the “C” statute does not specifically state that the trust is limited to a person under the age of 65, the transfer rules will apply to any person funding the trust who is 65 years or older. *See* discussion in Section III.A.4.a.(3), *supra*.

147. *See* Section II,B.3, *supra*.
148. The practitioner should keep close tabs on funding a SNT with a structure. In a case arising out of Florida, a Court created supplemental needs trust (SNT) was established and funded with a small lump sum. Additionally, a structured annuity paid \$2,000 per month for life into the trust. The trust was properly drafted to meet the requirements of federal and state law to preserve the beneficiary's eligibility for government benefits. Upon funding, the beneficiary was receiving SSI and attendant medicaid benefits. Because of his disability, the cost for his care was in excess of \$8,000 per month, which was being paid by Medicaid prior to the funding of the trust. When the structure began paying into the SNT, Social Security Administration denied eligibility for SSI claiming that the income paying into the trust was disqualifying income to the beneficiary! In February, 2004, the ALJ made a determination that the income was accessible to the trust beneficiary. 23 months after funding the trust the beneficiary is still without the necessary care and the appeal goes on. The general consensus (and hope) is that it case is an aberration. While payment of structured annuities into a properly drafted SNT has never been considered income to the beneficiary resulting in loss of benefits, it may be wise to make sure that there are sufficient funds in the trust to fund costs of litigation and sustain the beneficiary for more than a couple of months.
149. Barbara D. Goldberg and Kenneth Mauro, *Utilizing Structured Settlements*, Practising Law Institute. Litigation and Administrative Practice Course Handbook Series.
150. *Id.* referring to IRC §§104(a)(2) and 130; Revenue Ruling 79-220.
151. *Id.*
152. *See generally*, Medicare Secondary Payor Act, 42 USC 1395y.
153. Texas Family Code Chapter 7.
154. Texas Family Code, Chapter 8.
155. Texas Family Code §7.006.
156. Texas Family Code §154.001; Subchapter 154.301 *et seq.*
157. *See* Section III.A.4, *supra* discussing the “A” and “C” trusts.
158. *In the Matter of LaBarbera (Donovan)*, reported in 215 NYLJ 81, April 26, 1996, p.36, col. 6.
159. 42 U.S.C. §1395v(b)(2)(B)(I), §1396k(a)(1)(C), §2651; 42 C.F.R. §411.24(2)(h). The subrogation right is often referred to as a lien.
160. *Zinman v. Shalala*, 67 F. 3d 841, 844 (9th Cir. 1993).
161. Medicare Intermediary Manual §3418.; *United States v. Geier*, 816 F. Supp. 1332, 1334 (W.D.Wis. 1993). *But see*, Glenn E. Bradford and Melinda M. Ward, *The Medicare “Super Lien” Revisited*, 56 Journal of Missouri Bar 44, January/February 2000, p.45.(commentator argues that the government does not hold a lien right but rather a subrogation right). “It is commonly believed that if Medicare’s interest is not repaid, anyone who could have protected Medicare’s interest may be liable for such repayment. This idea possibly arises from the Medicare Secondary Payment Statute (MSP) 42 U.S.C. §1395y(b)(2)(B)(ii) by which an action may be brought against an entity responsible for payment or ‘any other entity... that has received ‘ a third party payment. Under the regulations, this includes even lawyers whose fees are paid from settlement proceeds. 42 C.F.R.

§411.24(g). However, the MSP does not give the government a claim against property. The statute states that the government may bring an action against the entity which is responsible to pay....” Glenn E. Bradford and Melinda M. Ward, *The Medicare “Super Lien” Revisited*, 56 Journal of Missouri Bar 44, January/February 2000., p. 46.

162. NAELA eBlast, by the Center for Medicare Advocacy, January 6, 2004.
163. *Id.*
164. *Id.*
165. Randal Kauffman, *The War of the Cockatrice*, 60 TxBJ 310, DATE.
166. *Id.*
167. 42 U.S.C. §1395y(b)(3)(A); 42 C.F.R. 411.24(c)(2).
168. 42 U.S.C. §1395y(b)(2)(B)(iv).
169. 42 U.S.C. §404(b); 20 C.F.R. 404.507; United States Health Care Finance Administration, Medicare Intermediary Manual §3418.13; *See Califano v. Yamasaki*, 442 U.S. 682, 685 (1979); *Villate v. Sullivan*, 862 F. Supp. 514, 517 (D.C. 1994); *Turner v. Sullivan*, 741 F. Supp. 263.268 (D.C. 1990).
170. Texas Human Resources.Code §32.033
171. *Kroeker v. State Farm*, 466 S.W.2d 105, 110 (Ct. App. 1971, no writ).
172. 950 S.W.2d 216, 219 (Tex.App.--Ft. Worth 1997, no writ).
173. *Id.* at 219.
174. 27 TexReg 4572.
175. The particular issue of whether or not TDHS has a right of recovery from the entire personal injury award or is limited to only that portion of the award identified as past medicals was addressed in *Calvanese v. Calvanese*, 93 N.Y.2d 111, 710 N.E.2d 1079, 688 N.Y.S.2d 479 (Ct. App.) writ ref'd. 528 U.S. 928, 120 S.Ct. 323, 145 L.Ed2d 252 (1999). In *Calvanese* the New York highest court affirmed the Appellate division finding that the Dept. of Social Services could recover from the whole award and was not limited to recovery from the portion designated as past medicals.
176. 1 T.A.C. §354.2301 et seq.
177. 1 T.A.C. §354.2313.
178. 1 T.A.C. §354.2315.
179. 1 T.A.C. §354.2332.
180. Frank Costilla, Jr., *Liens and Subrogation Rights and How to Handle Them*, ATLA Annual Convention Reference Materials, Volume 1, Motor Vehicle Collision, Highway, and Premises Liability Section, July 2000.
181. 1 T.A.C. §358.100.

182. 1 T.A.C. §358.415(h)(1).
183. 1 T.A.C.358.415(d).
184. 42 U.S.C. §1396p(e)(1); POMS SI 01120.201.
185. Recall that the grantor trust rules state that a person over the age of 65 cannot create a trust for him or herself without suffering the disqualifying transfer penalties. State Medicaid Manual, §3259.7B, see Appendix II. Additionally, if the irrevocable grantor trust allows for discretionary distributions from income, then all of the trust income is countable for eligibility purposes whether or not the trustee makes the distribution. The same rule applies to discretionary distributions of principal. See the discussion on Medicaid Qualifying Trust.
186. Steven M. Ratner, *Basic Elder Law 2001*, Tax Law and Estate Planning Course, Practising Law Institute, Nov. 7, 2001.
187. See Robert C. Lawrence III, *The Role of the Trust Protector or Protective Committee*, Practising Law Institute, Nov. 2001, §7:2.4.
188. *Id.*
189. *Id.*
190. *Id.*
191. Texas Probate Code §867.
192. Texas Probate Code §868.
193. Texas Probate Code §777.
194. POMS SI 01120.200D.1.a.
195. See Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues 2001, Portland, Oregon, June 17-22, 2001.
196. IRC §61 defines gross income.
197. POMS SI 00810.005.
198. Texas Medicaid Eligibility Handbook §E-1200.
199. See Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues 2001, Portland, Oregon, June 17-22, 2001.
200. See IRC §§671-678 for ways in which a retained interest in a trust might result in taxation of the trust to the grantor. On a national listserv there is much discussion about whether or not an “A” trust should be drafted to cause the trust to be a complex trust for income tax purposes. Recall that a complex trust is taxed by using compressed tax brackets. Why would one want such tax treatment? In the Victims of Terrorism Tax Relief Act of 2001, PL 107-134, enacted January 23, 2002, the IRC income tax treatment of complex trusts was amended allowing a court created supplemental needs trust (§1396p(d)(4)(A) trust) the same exemption amount that a taxpayer can claim (\$3,050) as

opposed to the standard \$100 or \$300 trust deduction. When the trust corpus is moderate to small and trust expenses are higher than normal (as in many supplemental needs trusts), there may be a greater tax savings in a complex trust under the new law.

While somewhat oversimplifying the rules, a complex trust results when there exists an adverse party such as a remainderman controlling distributions from the trust. In Texas, however, most "A" trusts are court created trusts. Under Texas Probate Code §867 or Texas Property Code §142.005, a SNT is generally a grantor trust because of the statutory requirements. The trust is funded with funds belonging to the grantor. Additionally, the two Code sections each require the appointment of a corporate fiduciary as trustee except in very narrow situations. Mandatory provisions of each statute also require, at termination, that the trust corpus must pass to the grantor or the grantor's estate. All of these statutory requirements precluded complex trust status. Thus, under IRC rules, Texas court created trusts will almost always be a grantor trust for income tax purposes negating the use of the Victims of Terrorism Tax Relief provision..

201. Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues, 2001, Portland, Oregon, June 17-22, 2001.

202. *Id.*

203. *Id.* One commentator notes that according to PLR 9444033, "the IRS takes the position that unless the trust by its terms required the remaindermen to reimburse the grantor for the taxes paid by the grantor on income not distributed to or for the benefit of the beneficiary, but in fact retained by the trust, the government will treat the applicable portion of the income tax payment as a gift by the grantor to the remaindermen. Dean S. Bress, *Focusing on Tax issues when Drafting Third Party Special Needs Trusts*, 26 Westchester Bar Journal, 53, 1999.

204. *Id.*

205. *Id.*

206. Dean S. Bress, *Focusing on Tax Issues when Drafting Third Party Special Needs Trusts*, 26 Westchester Bar Journal, 53, 1999.

207. POMS SI 01120.200 *et seq.*

208. *See Carnahan v. Ohio Dept. of Human Services*, 743 N.E. 2d 473 (Ohio App. 11th Dist. 2000)

209. 1 T.A.C. §§358.430(d)(2)..

210. §358.430(d)(3)

211. One should note that if grandmother has already funded an existing Crummey Trust, immediate problems may be avoided by simply stopping any lump sum gifting into the trust to avoid the withdrawal penalty. However, the trust may have to be judicially amended since many of these trusts terminate at a stated age (ie. age 25) and pay over the corpus to the beneficiary. Once the beneficiary has ownership of the corpus, the only way to maintain eligibility would be to fund a self-settled SNT which includes a pay back provision.

212. Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues 2001, Portland, Oregon, June 17-22, 2001.

213. *Moore v. Blackwell*, 85 S.W.2d 980 (Tex.Civ.App.–El Paso 1935, writ dismissed).
214. In several states, the Medicaid regulating agencies have disqualified Medicaid recipients for not making a spousal claim on the decedent spouse's estate when the decedent spouse's Will disinherited the surviving spouse. See *Tannler v. Wisconsin Dept. of Health and Social Services*, (Sup.Ct. Wisc., No. 96-0118, June 24, 1997); *Bezzini v. Conn. D.S.S.*, 18 Conn. L. Rptr., N. 12 (March 3, 1997), p.413; *Dionisio v. Westchester County Dept. of Social Services*, 665 N.Y.S. 2d 904 (1997 writ denied).
215. Texas Medicaid Eligibility Handbook §I-1210.
216. This discussion is not meant to be a treatise on using trusts as beneficiaries of qualified retirement plans but a general overview. This discussion will not address any estate tax issues that should be considered in funding a SNT.
217. Eric Viehman, *Estate Planning Under the New Minimum Distribution Rules*, Probate, Trusts and Estate Section, Dallas Bar Association, September 24, 2002, Appendix B-i.
218. *Id.*
219. *Id.*
220. *Id.*
221. *Id.*
222. Treas. Reg. §1.401(a)(9)-4.
223. Claflin, p. 4.
224. Treas. Reg. §1.401(a)(9)-9.
225. David Claflin, *A Practical Guide to Drafting Beneficiary Designations for IRAs, Qualified Plans, and Commercial Annuities*, The University of Texas Intermediate Estate Planning, Elder Law and Guardianship Course, Galveston, Texas, August, 2003, p.4.
226. *Id.* at p.7.
227. *Id.* at p.4. See also, Susan Slater-Jansen, "Final Regulations" Set Rules for Distributions from IRAs and Qualified Retirement Plans, New York State Bar Journal, February, 2003.
228. Ltr. Rul. 200228025
229. Treas. Reg. §1.401(a)(9)-5, A-5(a)(2).
230. Viehman, p. 5 citing to Treas. Reg. §1.401(a)(9)-5, A-5(c)(3).
231. Natalie Choate, *Life and Death Planning For Retirement Benefits*, Chap. 6.2, p.274.
232. Treas.Reg. 1.408-8, Q & A-1(a); Reg. 1.401(a)(9)-4, Q & A-5(b); Ltr. Ruls. 200211047 and 200109051.
233. IRC §4974.

234. For a discussion of beneficiary designation problems, see Natalie Choate's *Life and death Planning for Retirement Benefits*, Chapter 6.2.
235. See Robert C. Lawrence III, *The Role of the Trust Protector or Protective Committee*, Practising Law Institute, Nov. 2001, §7:2.4.
236. *Id.*
237. *Id.*
238. *Id.*
239. POMS SI 01120.200D.1.a.
240. See Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues 2001, Portland, Oregon, June 17-22, 2001.
241. IRC §61 defines gross income.
242. POMS SI 00810.005.
243. Texas Medicaid Eligibility Handbook §E-1200.
244. See Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA Elder Law Issues 2001, Portland, Oregon, June 17-22, 2001.
245. See Dean S. Bress, *Focusing on Tax Issues when Drafting Third Party Special Needs Trusts*, 26Westchester Bar Journal 53, 1999.
246. *Id.*
247. Cynthia L. Barrett, *Estate Planning in Depth*, ALI-ABA, Elder Law Issues, 2001, Portland, Oregon, June 17-22, 2001.
248. *Id.*