



Special Needs Trusts: An Overview For Financial Planners*

I. Purpose

Special Needs Trusts are designed to permit financial resources to remain available to assist a disabled individual who receives, or may receive in the future, Medicaid (Medical Assistance) and/or SSI and/or Mental Health/Mental Retardation benefits. These Trusts also protect resources from immediate invasion by the state Medicaid agency (in Pennsylvania, the Department of Public Welfare and in Maryland, the Department of Health and Mental Hygiene) to reimburse the public treasury for the provision of MA, SSI or other public benefits.

II. Types of Special Needs Trusts

- A. The first type is a "Common Law Special Needs Trust" or a "Third Party Funded Special Needs Trust" which involves a Trust funded someone other than the disabled person. The controlling cases in Pennsylvania regarding Common Law/Third Party Funded Special Needs Trusts using the resources of third parties are Lang v. Commonwealth, Department of Public Welfare, 515 Pa. 428, 528 A.2d 1335 (1987) (discretionary trust held not invadable to pay DPW for mental retardation benefits); Commonwealth Bank and Trust v. Commonwealth, Department of Public Welfare, 528 Pa. 482, 598 A.2d 1279 (1991) (trust disqualified beneficiary for MA due to testator's legal duty to care for beneficiary, failure of trust to refer to public benefits as an available resource, and fact that principal could be spent without concern for remaindermen); Snyder v. Commonwealth, Department of Public Welfare, 528 Pa. 491, 598 A.2d 1283 (1991) (trust not an "available resource" for purposes of determining son's eligibility for medical assistance benefits); Estate of Rosenberg v. Department of Public Welfare, 545 Pa 27,

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679 A.2d 767 (1996); (trust disqualified beneficiary for MA where intent of settlor was not clear regarding desire to ensure future eligibility for public benefits); Shaak v. Department of Public Welfare, 747 A.2d 883 (Pa. 2000); (inter vivos trust found to be an “available resource”, because the Settlor/Beneficiary “clearly intended that the Trust be used for her benefit during her lifetime” and principal could be used for “maintenance and welfare” of the Beneficiary); Estate of Taylor, 825 A.2d 763 (Pa. Cmwlth. 2003).

In Maryland, see First Nat’l Bank v. Dep’t of Health, 284 Md.720, 399 A.2d 891 (1979) (a properly drafted third-party funded special needs trust is not liable for medical assistance provided to the disabled beneficiary and distribution cannot be compelled from pure discretionary trust unless shown trustee acted in bad faith or beyond bounds of reasonable judgement).

1. Factors To Consider In Establishing A Common Law/Third Party Funded Special Needs Trust

- a. It must be clearly stated that (1) it is the intent of the settlor to supplement and not supplant public benefits and that such benefits be considered prior to distribution of any trust income or principal, (2) the trust is irrevocable, and (3) the trustee has total, absolute and unfettered discretion to pay, or refuse to pay, income or principal from the trust to the disabled beneficiary. Never instruct the trustee to make periodic (e.g. monthly) payments, as all payments should be discretionary and generally cannot be made for food or shelter under MA or SSI rules.
- b. The courts also appear to consider other factors, perhaps as indicia of the settlor's intent;
 - i. The existence of other beneficiaries;

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- ii. The existence of remaindermen with a statement of intent that the settlor wishes the trustee to attempt to preserve at least some assets for the remaindermen;
- iii. The trustee is instructed to consider the interests of all other beneficiaries, including contingent beneficiaries, before making distributions;
- iv. The lack of a duty of the settlor to support the disabled beneficiary.

B. Self-Funded or "Payback" Special Needs Trusts -- 42 U.S.C. Section 1396 p(d)(4)(A)

- 1. Amendments to the Medical Assistance rules under OBRA-93 require that where the beneficiary's own monies are used:
 - a. The Trust must be created irrevocably for the benefit of a disabled individual under age 65. Pennsylvania and other states interpret this provision to require that the Trust be used for the sole benefit of the disabled beneficiary.
 - b. the trust must be created by the beneficiary's parent, grandparent, guardian or a court;
 - o Pennsylvania's Act 42 of 2005 now requires that "before the funding of a Special Needs Trust, all liens and claims in favor of the Department for repayment of cash and Medical Assistance shall first be satisfied." 62 P.S. Section 1414(d). No provision in the Social Security Act requires that all such liens be

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satisfied prior to the creation of a Special Needs Trust, although where the Special Needs Trust is funded through the proceeds of a personal injury action, Pennsylvania and federal law have long required that Medical Assistance paid on account of the accident be repaid before any recovery is paid to the plaintiff or a Trust for the plaintiff. Query: Does this mean that all prior Medical Assistance expenditures must be repaid before funding the Trust, including Medical Assistance payments which were unrelated to an accident which gave rise to the recovery which will fund the Trust? It would appear that DPW has no formal "lien" to recover for Medical Assistance payments except 1) from a litigation fund to repay Medical Assistance for benefits provided as a result of the accident, 62 P.S. §1409(b)(1), and 2) for Medical Assistance provided after the age of 55. 62 P.S. §1412. With respect to DPW's claims concerning cash assistance, see 62 P.S. §1974. Only time will tell exactly how DPW will interpret this new provision.

- c. The Trustee must have total discretion to pay, or refuse to pay, resources of the Trust to the beneficiary;
 - o Pennsylvania Act 42 of 2005 provides at 62 P.S. Section 1414(b)(2) that a Special Needs Trust may only be funded with a disabled person's own money where "the beneficiary [has] special needs that will not be met without the Trust." Query: When is this determination made, and does this mean that a disabled beneficiary's monies may not be

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used to create a Special Needs Trust if that person's "special needs" can be met with that person's own monies or with other resources? No similar provision exists under 42 U.S.C. Section 1396p(d)(4).

- o Pennsylvania Act 42 of 2005 requires that "any expenditure from the Trust must have a reasonable relationship to the needs of the beneficiary." 62 P.S. Section 1414(b)(3)(ii). This provision appears to be designed to curb real or imagined "excesses" in the use of self-funded Special Needs Trusts for extravagant luxuries. However, the Act provides no guidance as to what constitutes a "reasonable relationship to the needs of the beneficiary."
 - o COMAR 10.09.24.08-2(a)(b) (Maryland) mandates that expenditures from the trust shall be used for the sole benefit of the beneficiary and shall be directly related to the beneficiary's health care, education, comfort, or support.
- d. the trust must state that monies in the trust at the beneficiary's death be made available to repay the state for Medical Assistance payments made on behalf of the beneficiary during his/her lifetime. Upon the death of beneficiary, the Trustee in Pennsylvania must contact:

Department of Public Welfare
Third Party Liability Casualty Unit
Special Needs Trust Depository
P.O. Box 8486
Harrisburg, PA 17105
(717) 772-6257

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- o Pennsylvania Act 42 of 2005 requires that “upon the death of the beneficiary or upon the earlier termination of the Trust, the Department and any other State that provided Medical Assistance to the beneficiary must be reimbursed from the funds remaining in the Trust up to an amount equal to the total Medical Assistance paid on behalf of the beneficiary before any other claimant is paid; provided, however, that in the case of an account in a Pooled Trust, the Trust shall provide that no more than fifty (50%) percent of the amount remaining in the beneficiary’s Pooled Trust account may be retained by the Trust without any obligation to reimburse the Department.” 62 P.S. Section 1414(b)(3)(iii). This provision appears contrary to federal law on two scores. First, federal law requires reimbursement to the Department only upon the death of the beneficiary, and not upon other circumstances which terminate the Trust, although it is conceivable that courts would interpret the federal law in a manner consistent with Act 42 to avoid abuses such as where the Trust is terminated just prior to the death of the disabled beneficiary. Second, the Social Security Act provides no basis upon which the Department can demand that Pooled Trusts repay fifty (50%) percent of Medical Assistance paid on behalf of the disabled beneficiary of a Pooled Trust; to the contrary, federal law requires that where a Pooled Special Needs Trust vehicle is used, the entire residuary of the Trust remain in the Pool for the benefit of other individuals with disabilities. 42 U.S.C. §1396p(d)(4)(C).

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- e. Pennsylvania Act 42 of 2005 requires DPW to determine whether the Trust conforms with “any regulations or statements of policy adopted by the Department to implement this section.” 62 P.S. Section 1414(b)(4). Query: Does this mean that even informal policy statements of the Department become binding law in determining the legality of Special Needs Trusts? This circumstance presents real concerns, especially given the current policy of the Department in stretching federal law beyond the express mandate of the Social Security Act through the provisions of Act 42.

- f. Pennsylvania Act 42 of 2005 provides that “if at any time it appears that any of the requirements of [Act 42] are not satisfied or the Trustee refuses without good cause to make payments from the Trust for the special needs of the beneficiary...the Department or other public agency may petition the court for an Order terminating the Trust.” 62 P.S. Section 1414(c). This provision apparently gives broad authority to not only the Department, but any “other public agency” to petition the Court to terminate the Trust if it believes that, for example, the beneficiary’s special needs can be met without the Trust or that expenditures from the Trust have not had a “reasonable relationship to the needs of the beneficiary”. Therefore, it is possible that agencies such as County Mental Health/Mental Retardation Administration or other social service agencies might petition the court to terminate the Trust in order to avoid providing public entitlements.

- g. Pennsylvania Act 42 of 2005 requires that “at the death of the beneficiary or upon earlier termination of the Trust, the Trustee shall notify and request a

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Statement of Claim from the Department, addressed to the Secretary.” 62 P.S. Section 1414(e). This provision again refers to “earlier termination of the Trust” in a manner which does not fully mirror federal law.

- h. Some additional Maryland requirements include:
- The trust beneficiary may not serve as trustee, co-trustee, trust protector, trust advisor, or in any other capacity that would allow the beneficiary to influence or exercise authority or control over distributions from the trust;
 - Any leases or mortgages that the trust may hold must contain a provision that they either terminate or become due and payable upon the death of the beneficiary or termination of the trust;
 - If the trust owns titled property that is valued at more than \$500, the property must be titled in the name of the trust, except for securities, which may be held in the name of a nominee;
 - Trust assets may not be used to compensate family members of the beneficiary for serving the beneficiary in any way, including caring for the beneficiary, accompanying the beneficiary on travel, providing companionship to the beneficiary, or serving as trustees or members of a trust advisory committee;
 - Trust assets may not be used to purchase gifts;

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- The only real property in which the trust may invest is in a single home property, which is used as the residence of the beneficiary and is titled in the name of the trust;
 - The trust may not disburse more than \$100,000 for the purchase of property without the approval of the State circuit court in the jurisdiction in which the beneficiary resides;
 - An annual accounting of the trust, including a listing of the current assets, income, and itemized distributions during the previous year, must be sent to the Maryland Medical Assistance Program, Division of Recoveries and Financial Services
- i. Other state limitations on the uses and applications of self-funded special needs trusts include differences in what types of distributions are proper, to whom certain distributions are proper, what is defined as income, and what are exempt resources.
- In New Jersey, if a person other than the disabled beneficiary is to receive a benefit from the trust, that individual must contribute back to the trust something of equivalent value.
 - Arizona, Maryland and Mississippi both bar payment to family members for personal care services
 - Arizona does not allow for travel expenses for a person accompanying the disabled beneficiary.

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- o New Mexico prohibits disbursements to persons other than the beneficiary, as well as to disbursements to the beneficiary that benefit another.
 - o Distributions for food and shelter are treated as income in New Jersey and Colorado; New Mexico will not approve a trust that allows for distributions for food, shelter or cash.
 - 2. The Pennsylvania Rules of Civil Procedure explicitly permit the use of self-funded special needs trusts in resolving civil litigation. See Rules 2039 (minors), 2264 (incompetents), and 2206 (settlements in death cases where a minor or incompetent has an interest). See also, Local Rule 41.2 of the Rules of Civil Procedure for the Eastern District of Pennsylvania.
 - 3. Where SSI eligibility is also an issue, and the beneficiary's own monies are used to fund the trust, the SSI Guidelines may consider the trust to be revocable (and thus an available asset) unless a contingent beneficiary is named.
- C. Pooled Trusts - Authorized by 42 U.S.C. Section 1396p (d)(4)(C) and 62 P.S. Section 1965.1 et. seq.
- 1. Must use non-profit agency as Trustee.
 - 2. Under the federal statute no payback is required, but resources remain in the pooled trust after the death of the beneficiary for the benefit of persons with disabilities. See discussion regarding payback from pooled trusts in the preceding section.
 - 3. Query: Must the disabled beneficiary be under age 65?
 - 4. Examples of pooled trusts:

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The ARC Community Trust of Pennsylvania (610) 265-4788
(King of Prussia)
The Family Trust, Achieva (412) 995-5000 (Pittsburgh)

III. Thorny Issues in the Creation and Maintenance of Special Needs Trusts

A. Creation of Special Needs Trusts - Preliminary Issues

1. Must state agency approval for the Trust be obtained?
 - a. Is the money arising from litigation involving a minor or incapacitated person? In what county?
 - b. What will the state agency require?
 - (i) notice of expenditure of principal
 - (ii) some limits on types of expenditures
2. Should you create a SNT if
 - the beneficiary is marginally disabled?
 - the beneficiary does not currently receive SSI or Medical Assistance, but may in the future?
 - the trust corpus is relatively small -- can you spend down without losing eligibility (even if only for one month)?
 - the trust corpus is so large that SSI and MA could be irrelevant (and can the SNT be drafted in such a way as to pay out monies for food, shelter, clothing and cash payments until the beneficiary goes on to MA/SSI)
 - Other health benefits are available (e.g. Medicare, tobacco settlement programs)
3. Whose money is it, anyway? OBRA-93 Trust vs. Common Law Special Needs Trust -- The Payback Issue

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- a. inheritance not yet paid out
 - b. injury settlement
 - c. past Social Security award
 - d. compensatory education fund
 - e. reversionary interest in property
 - f. can you combine - and is it ever wise to combine -- assets of the person with disabilities and assets of others?
 - g. life insurance companies are now marketing to families with persons with disabilities
4. What do you tell the Trustee about administering the Trust?
 5. Must the Settlor have the legal authority to manage the assets of the disabled beneficiary? What are the differing demands of the state agency, SSA, local agencies?
 6. What Social Security number do you use?
 7. Who should be the contingent beneficiaries?
 8. How do you get the court to act as settlor for the trust when no parent, grandparent or guardian is available?

B. Larger Trusts

1. Should you use a corporate or non-corporate trustee?
2. Which corporate trustee is best? Issues to consider are fees, customer service history, knowledge of SNTs and disability issues, and investment strategies.
3. Financial demands upon the trustee by the beneficiary and the family can be vexatious, and can include salaries for family members to care for the disabled beneficiary,

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housing for entire family, family vacations, vehicles not specially designed for the disabled beneficiary food, clothing, rent/mortgage, or cash for disabled beneficiary, furniture, electronic equipment, professional services.

C. Smaller Trusts

1. Trustee

- a. Can you find a capable corporate trustee?
- b. Will the Court appoint a non-corporate trustee in matters involving a minor or incapacitated person?

PA R.C.P., Rules 2039 and 2064 technically requires use of a corporate trustee, but counsel should also examine any available non-corporate trustee. Will the Court approve a family member, friend, financial planner, or attorney? Are conflicts of interest involved?

- c. Can you keep a trustee happy if the beneficiary or his/her family is demanding? Issues can involve payment of fees to trustee, investment counseling, and supportive/intervention/casework services.

2. Beneficiary

- a. Should the trustee accede to requests which will quickly deplete the corpus?
- b. Can principal be invaded? Will the state agency object?
- c. How should the corpus be invested?

D. Improper SNTs – can they be “fixed”?

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E. Payback Issues

1. Planning for payback during trust administration.
2. Dealing with the state agency at the termination of the Trust.

F. Support Issues

Ricco v. Novitski, 874 A.2d 75 (Pa. Super 2005). The existence of a Special Needs Trust for a child with disabilities is not a factor in determining the support obligations of the parents of the child, and a parent cannot evade support obligations due to the existence of a Special Needs Trust. Query: How will this case relate to the broad familial support obligations under Act 43 of 2005, 23 Pa. C.S.A. Section 4601 et. seq.?

G. Fees in Personal Injury Cases Where Court Approval is Necessary

1. The payment to the attorney who drafts the trust should be charged as a cost of litigation and paid via the personal injury attorney.

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