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TYPES OF SPECIAL NEEDS TRUSTS

By Thomas D. Begley, Jr., Esquire

There are essentially two types of special needs trusts: third party trusts and self-settled trusts. This article will discuss the features that are common to both trusts. In addition, there are pooled trusts. Pooled trusts can be either third party or self-settled. The distinction between a third party special needs trust and a self-settled special need trust is the source of funds. If the assets funding the trust are not the assets of the beneficiary but belong to a third party, then the trust is a third party trust. If the assets funding the trust are assets of the disabled beneficiary, then the trust is a self-settled trust.

Some trusts are pooled trusts in which the assets of many trusts are combined for investment purposes, but are managed individually for distribution purposes. There is a master trust document that is adopted to govern the trust. A pooled trust can be a self-settled trust or a third party trust, depending on whether the assets used to fund the trust belong to the person with disabilities or to a third party. Some pooled trusts provide that assets remaining in the pool upon the death of the person with disabilities is retained by the trust. Not all pooled trusts qualify under 42 U.S.C. §1396p(d)(4)(C). Some trusts simply pool assets together for investment purposes, but do not qualify under OBRA '93.

Third Party Trust

The first type of special needs trust that disability law attorneys commonly draft is a third party special needs trust, which is established by the third party *with assets of the third party* for the benefit of a person with a disability. Typically, these trusts are established by a parent for the benefit of a child with a disability. In drafting third party special needs trusts, the attorney need not be concerned with Medicare

claims, Medicaid liens, or age limits relating to the beneficiary. There is no requirement that the state Medicaid agency be paid back funds on the death of the beneficiary. If income from the trust is distributed to the beneficiary, it may reduce or eliminate public benefits. Therefore, income should be distributed to third parties to pay for goods and services delivered to the beneficiary. Similarly, the assets in the trust must not be available to the beneficiary. Therefore, the attorney has great flexibility in structuring the trust to achieve the income, gift and estate tax goals of the settlor.

There is no federal statutory authority for a third party special needs trust. However, the Social Security administration has policy regarding the effect of these trusts on benefits.^[1]

Self-Settled Trust

The federal statutory authority for a self-settled special needs trust is found at 42 U.S.C. §1396p(d)(4)(A)(payback trusts) and d(4)(C) (pooled trusts) and at HR 3443 Foster Care Independence Act of 1999 §205.^[2] A self-settled special needs trust most frequently is a (d)(4)(A) trust and is referred to that way. It is established *with the assets of the person with a disability*. It must be established by the parent, grandparent, guardian of the person with a disability, or by a court. Only the person with a disability can be the beneficiary of the trust. These trusts are frequently used when an injured party receives money as a result of a tort action. The trust must be an inter vivos trust, rather than a testamentary trust, and it must be irrevocable. Prior to establishing the trust, the attorney must be concerned with the existence of any Medicare claim and Medicaid lien as well as claims for reimbursement from third party liability insurers. The trust cannot be established if the beneficiary is over age 65. On the death of the beneficiary, assets remaining in the trust must be used to pay back any state Medicaid agency providing benefits. There is considerably less flexibility with respect to achieving tax goals.

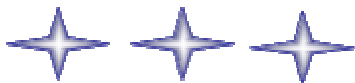
Special Needs Trust Comparison

Issue	Third Party SNT	Self-Settled SNT
Established By	Third Party	Parent, Grandparent, Guardian, or Court
Funded by Assets of	Third Party	Person with a Disability
Beneficiary	Person with a Disability and Nondisabled Person	Person with a Disability Only
Grantor Trust	Can Be	Yes
Grantor Trustee	Can Be	No
Discretionary	Yes	Yes

^[1] POMS SI 01120.200 *et seq.*

^[2] 42 U.S.C. §1382(b).

Inter Vivos	Yes	Yes
Testamentary	Yes	No
Revocable	Can Be	No
Gift Tax Annual Exclusion	Can Use	Cannot Use
Estate Tax	Can Be Excluded	Includable
Distributions	Payments to Third Parties	Payments to Third Parties
Disability	SSA Definition	SSA Definition
Pay Back Provision	No	Yes
Medicare Claim	No	Yes
Medicaid Lien	No	Yes
Age Limit	None	Under 65
Qualified Disability Trust	Yes	No



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Begley & Bookbinder

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