

**THE INTERSECTION OF TRUST,
TAX AND PUBLIC BENEFITS LAW**

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A. **INTRODUCTION**

Elder law attorneys acquire an expertise in trust, tax, and public benefits laws. This expertise is at the heart of our profession. In order to determine whether or not a client requires a trust and, if so, what type of trust, the attorney must have a basic understanding of trust law, tax law, and public benefits law.

B. **BENEFIT PROGRAMS AFFECTING THE DISABLED**

In order to determine when the use of a Special Needs Trust is appropriate, it is necessary to have an understanding of government benefit programs affecting the disabled. The principal programs are:

- SSI
- Medicaid
- SSD
- Medicare
- Federally-assisted Housing

1. **SSI**

a. **Benefits**

The purpose of the SSI payment is to provide the recipient with income to be used for food and shelter.¹ SSI is an income maintenance program for poor people. It is designed to provide recipients with 75% of the federally-defined poverty level. For 2005, the maximum federal SSI monthly payment for an individual is \$579 per month.² For a couple, the maximum monthly payment is \$869.³ Many states provide a small supplement to the federal benefit. Any countable income paid to the recipient is deducted from the basic federal SSI payment. Income is countable whether earned or unearned, and certain in-kind assistance is also deemed as income.

b. **Eligibility**

There are five eligibility requirements for SSI.

- Categorical
- Residence
- Financial
- Application for Other Benefits
- Non-Institutionalization

¹20 C.F.R. § 416.110.

²42 U.S.C. § 1382f(a); 68 Fed. Reg. 60438.

³*Id.*

(1) Categorical

An applicant for SSI must be at least 65 years of age, blind, or disabled.⁴

SSI uses the Social Security definition of disability. "Disability means the inability to do 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. The impairment must be so severe that the claimant is unable to do his or her previous work or any other "substantial gainful activity" which exists in the national economy. The person's "residual functional capacity" and age, education and work experience will be considered in determining whether the person is able to do other work."⁵ Drug and alcohol addiction are no longer a basis for SSI eligibility.⁶

A child under the age of 18 is considered disabled for SSI purposes, if the child has a medically-determinable physical or mental impairment which results in "marked and severe functional limitations."⁷

Substantial Gainful Activity (SGA) for a disabled person is the ability to earn \$830 per month in the workplace effective January 2005. For a blind person SGA is \$1,380. This is indexed for inflation. In the future SGA will be determined by the ratio of the national average wage index for the previous two years; comparing that amount to the current SGA level and taking the greater of the two.⁸

(2) Residence

An SSI recipient must be a citizen of the United States or meet the eligibility requirements of the 1996 Welfare Act and the Balanced Budget Act of 1997. Residency must be for a period of 30 consecutive days.⁹ Absence from the United States for a period of 30 consecutive days terminates a person's rights to SSI, but a new application can be made after a new 30-day period of residency is established.

(3) Financial

SSI recipients must first meet financial tests. SSI is a means-tested program.

⁴42 U.S.C. § 1382c(a)(1)(A).

⁵42 U.S.C. § 1382c(a)(3)(A); 20 C.F.R. § 416.905.

⁶42 U.S.C. § 1382c(a)(3)(J).

⁷42 U.S.C. § 1382c(a)(3)(B).

⁸69 Fed. Reg. 62497 (Oct. 26, 2004).

⁹42 U.S.C. § 1382(f).

(a) Income

SSI categorizes income as countable and non-countable, earned or unearned, and cash or in-kind. The first \$20 of most income received in a month is disregarded. Income is defined as "anything a person receives in cash or in-kind that can be used to meet a person's needs for food or shelter."¹⁰ Certain items cannot be used for food or shelter and are, therefore, not counted as income. These are found at 20 C.F.R. §416.1103. Receipt of cash income reduces SSI payments dollar-for-dollar.

(b) Earned income

Earned income is defined as wages before deductions and net earnings from self-employment.¹¹ However, there are certain exclusions from earned income. These exclusions include: federal assistance payments; \$10 per month of infrequent income; \$65 plus one-half of remaining income per month¹². Certain special exclusions apply to blind and disabled persons.

(c) Unearned income

Unearned income is defined as all income that is not earned.¹³ Examples of unearned income include: interest; dividends; alimony; annuities; pensions; and, inheritances. Exclusions from unearned income are limited to tuition scholarships, \$20 of infrequent income, and one-third of child support payments to the disabled child.

(d) ISM rules

In-kind Support and Maintenance (ISM) is the receipt of food or shelter furnished by a third party.¹⁴ This will reduce a recipient's benefits.¹⁵ The idea is that since SSI benefits are specifically intended to pay for a person's food and shelter, if that person receives food or shelter from another source, then less SSI benefits are needed. The reduction of SSI benefits for ISM is not on a dollar-for-dollar basis as with cash. A recipient's living arrangements determine whether in-kind support and maintenance is valued by the one-third reduction rule or the presumed-value rule. If a recipient lives in the household of another, the SSI benefit would be reduced by one-third.¹⁶ However, there is no reduction if the recipient pays a *pro rata* share of the food or shelter expenses.¹⁷

Where the recipient lives in his or her own household, the "presumed-value" rule does apply.¹⁸ This means that the payment is reduced by one-third of the benefit rate plus \$20.

¹⁰20 C.F.R. § 416.1102; 70 Fed. Reg. 6340 (Feb. 7, 2005).

¹¹42 U.S.C. § 1382a(a); 20 C.F.R. § 416.1110.

¹²20 C.F.R. §§ 416.1112(b) and (c).

¹³42 U.S.C. § 1382a(a)(2); 20 C.F.R. § 416.1120.

¹⁴20 C.F.R. § 416.1130(b) ; 70 Fed. Reg. 6340 (Feb. 7, 2005).

¹⁵20 C.F.R. §§ 416.1100 and 416.1130(b).

¹⁶42 U.S.C. § 1382a(a)2(A); 20 C.F.R. § 416.1131.

¹⁷20 C.F.R. § 416.1133(a).

¹⁸20 C.F.R. § 416.1140.

(e) Deeming of income

Income of an ineligible spouse or ineligible parent or sponsor of an alien is deemed to the SSI applicant.¹⁹ Living arrangements determine when deeming occurs. If the claimant lives in the same household as the ineligible spouse or parent, deeming will occur. This means that in calculating the income of the SSI applicant, the income of the ineligible spouse or parent living in the same household will be attributed to the SSI applicant. Income from the sponsor of an alien is deemed to the SSI applicant, even if a residence is not shared. If a child under 18 lives in the household of a parent, the income of the parent is deemed to the child. This is why children under 18 seldom receive SSI payments unless their parents have income below the poverty line. Once a child reaches 18, the income of the parent is no longer deemed to the child.

(f) Resources

As a general rule, the countable resources of a single person cannot exceed \$2,000, and the countable resources of a married couple cannot exceed \$3,000 if they are living together.²⁰ "Resources" means cash or other liquid assets, or any real or personal property that a person or his/her spouse own and can convert to cash for support and maintenance.²¹

As with income, resources are deemed. Living arrangements determine the deeming of resources. A person living with an ineligible spouse has the resources of the ineligible spouse deemed himself or herself. A child under 18 years of age living with an ineligible parent suffers the same result. However, upon the child attaining 18, the resources of the parent are no longer deemed to the child living in the household of a parent. Similarly, resources of an alien's sponsor in excess of \$2,000 for an individual, \$3,000 for a couple, are deemed to the alien.

However, certain resources are non-countable. These include: the individual's home, if it is occupied by the individual as his or her principal residence or, if the person is institutionalized, if the home is occupied by the spouse, or by a child under 21 blind or disabled²²; household goods if they are items of personal property, found in or near the home, that are used on a regular basis or items needed by the household or for maintenance, use and occupancy of the premises as a home;²³ personal effects will not be counted as resources if they are items of personal property ordinarily worn or carried by the individual, or articles otherwise having an intimate relation to the individual;²⁴ one automobile, regardless of value, if it is used for transportation for the individual or a member of the individual's household;²⁵ the cash values of life insurance policies are excluded if the face value does not exceed \$1,500 on all such policies; burial plot and funds for burial up to \$1,500 per individual are also excluded; and, assets held in a Uniform Gifts to Minors Account (UGMA)

¹⁹20 C.F.R. § 416.1160(a).

²⁰20 C.F.R. § 416.1205(c).

²¹20 C.F.R. § 416.1201(a).

²²42 U.S.C. § 1382b(a); 20 C.F.R. §§ 416.1210 and 416.1212.

²³ 70 Fed. Reg. 6340 (Feb. 7, 2005).

²⁴ *Id.*

²⁵ *Id.*

(g) Application for other benefits

A person must file an application for SSI benefits and also for any other benefits to which the person may be entitled.²⁶ Receipt of the other benefits will reduce or eliminate the SSI benefit. Reduction is on a dollar-for-dollar basis. This explains why certain disabled persons receive SSI, Medicaid, as well as SSD and Medicare. For this combination to occur, the SSD payment must be lower than the SSI benefit, which the individual would have received if he or she were not also eligible for SSD.

(h) Transfer penalties

An individual or spouse who disposes of resources for less than fair market value during a 36-month lookback period,²⁷ the individual is ineligible for benefits for a period of time. The period is calculated by dividing the uncompensated value of the transfer by the amount of the maximum monthly benefit payable, including any state supplement.²⁸ The penalty is rounded to the nearest whole number with a cap of 36 months.²⁹ The penalty begins the first month in or after which resources were transferred which does not occur during any other period of ineligibility.³⁰

2. Medicaid

Generally, Medicaid is a welfare program which pays medical bills for the aged, blind and disabled who meet certain requirements. It is a medical *payment* program, not a medical *insurance* program. Medicaid is means-based with both income and resource testing. The law is found at 42 U.S.C. §1396 and 42 C.F.R. § Parts 430, 431, and 435. The Medicaid law is Title XIX of the Social Security Act.

Medicaid pays for a very broad spectrum of medical services including hospital stays, physician services, community-based health care and nursing services, and prescriptions. It also pays certain housing costs, and for some, vocational and employment services and transportation. There are no deductibles, co-payments or financial limits on coverage.

3. Social Security Disability

This program is known as the Old-Age, Survivors, and Disability Insurance (OASDI). It is found at Title II of the Social Security Act.³¹ The regulations are found at 20 C.F.R. §404.1 *et seq.* Unlike SSI, which is a means-tested welfare program, Social Security Disability (SSD) is an insurance program. Coverage is based on quarters of Social Security insurance coverage during the applicant's employment.

²⁶42 U.S.C. § 1382(e)(2); 20 C.F.R. §§ 416.210(a) and (b).

²⁷H.R. 3443 Foster Care Independence Act of 1999 § 206(c)(ii)(I).

²⁸*Id.* at § 206(iv).

²⁹*Id.*

³⁰*Id.* at § 206(iii).

³¹42 U.S.C. § 401 *et seq.*

The disabled wage-earner is entitled to benefits. The spouse and children of a disabled wage-earner are entitled to Dependent's Benefits based on the record of the retired wage-earner. A disabled surviving spouse and surviving disabled or non-disabled children may all be entitled to Survivor's Benefits based on the record of the deceased wage-earner.

4. Medicare

Medicare is a program that pays the medical costs of eligible beneficiaries. Unlike Medicaid, which is a welfare program, Medicare is an insurance program. Medicare pays for acute-care, hospitalization, limited skilled nursing care, doctor's fees, drugs and medications used in the hospital and home care under certain circumstances. Home care is the fastest growing area of the Medicare budget and includes some care for the chronically ill. Medicare has open enrollment at any time without any problem with pre-existing conditions. This is true of traditional Medicare and Medicare managed care. The law is found at 42 U.S.C. §1395. Regulations are found at 42 C.F.R. Parts 405-421.

Medicare is divided into four parts. Part A covers hospital care, Part B covers physician and outpatient services. Part C is a new managed care program called Medicare Part C Plus Choice Program, which is essentially a Medicare HMO, and Medicare Part D, which begins in January 2006 and will be a prescription drug benefit.

5. Benefit Programs Comparison Chart

These two charts are designed to indicate, at a glance, the differences between SSI and SSD, and Medicaid and Medicare.

The chart 2-1 is designed to show at a glance the principal differences between SSI and SSD.

ISSUE	SSI	SSD
Basis	Welfare	Insurance
Benefit	75% of Federal Poverty Level	Based on Earnings Record
Must Apply for Other Benefits	Yes	No
Income Limits	Yes	No
Resources	\$2,000	Unlimited
Transfer Penalty	Yes	No
Medical	Medicaid	Medicare After Two Years
Disability	SSA Definition	SSA Definition

The chart 2-2 is designed to show at a glance the principal differences between Medicaid and Medicare.

ISSUE	MEDICAID	MEDICARE
Hospital Coverage	Yes	Yes
Doctor Coverage	Yes	Yes
SNF Coverage	Yes	Severely Limited
Home Care	Limited	Limited
Deductible, Co-Payments and Limits	None	Yes
Financing	Federal and State Tax Funds	Payroll Deduction Taxes and Premiums

C. THE STATUTE AND THE POMS AND SNTs

1. Statutory Considerations When Drafting a Special Needs Trust

Section 1396(p)(d)(4)(A) of the Social Security Act³² and certain provisions of the Foster Care Independence Act of 1999³³ apply to self-settled special needs trusts. They do not apply to third party special needs trusts. If the assets of the individual beneficiary are used to establish the trust, it is considered a self-settled trust.³⁴ If assets of someone other than the beneficiary are used to establish the trust, it is considered a third party trust.

If the trust is revocable, it is considered an available resource.³⁵ If the trust is irrevocable, the trust is considered an available resource to the extent that payments from the trust could be made to or for the benefit of the grantor or the grantor's spouse.³⁶ However, the transfer provisions of the Social Security Act and Medicaid do not apply to self-settled trusts.³⁷

2. POMS Considerations When Drafting a Special Needs Trust

Drafting a special needs trust requires designing it in a manner which takes into consideration the Program Operations Manual System (POMS), which is published by the Social Security Administration (SSA) and contains the operating procedures for SSI. Significant

³² 42 U.S.C. §1396p(d)(4)(A)

³³ H.R. 3443 Foster Care Independence Act of 1999 § 205.

³⁴ *Id.* at § 205(e)(2)(A).

³⁵ *Id.* at § 205(e)(3)(A).

³⁶ *Id.* at § 205(e)(3)(B).

³⁷ 42 U.S.C. § 1396(p)(d)(4)(A).

changes were made in 1999 in the sections pertaining to trusts.³⁸ A discussion of the POMS is instructive.

a. Trust

The POMS recognize the trust device. In fact, the POMS contain a definition of a trust. "A trust is a property interest whereby property is held by an individual (trustee) subject to a fiduciary duty to use the property for the benefit of another (the beneficiary)."³⁹

b. Discretionary

The POMS defines a discretionary trust as "A discretionary trust is a trust in which the trustee has full discretion as to the time, purpose and amount of all distributions. The trustee may pay to or for the benefit of the beneficiary, all or none of the trust as he or she considers appropriate. The beneficiary has no control over the trust."⁴⁰ The key to the entire issue of "availability" is the discretion of the trustee. If the beneficiary has no right to compel distribution or to revoke the trust, the trust is discretionary and the trust assets will be unavailable.

c. Residual beneficiary

Whether the trust has named a residual beneficiary is important in some states in determining whether or not the trust is revocable and, therefore, available. A residual beneficiary is defined as "A residual beneficiary is not a current beneficiary of a trust, but will receive the residual benefit of the trust contingent upon the occurrence of a specific event, e.g., the death of the primary beneficiary."⁴¹

d. Trusts as resources

SSA follows state law with respect to whether or not a trust is revocable. Most states follow the general principal that if a grantor is also the sole beneficiary of the trust the trust is revocable, but if there is a named "residual beneficiary" then the trust is irrevocable.⁴²

e. Revocation

In a third party special needs trust, revocation is not usually an issue, because the grantor and the beneficiary are different and a residual beneficiary is named to take the trust assets upon the death of the beneficiary. The beneficiary, therefore, has no authority to revoke the trust. Draftsmen do not always include a residual beneficiary and, therefore, revocation becomes an issue. The POMS state "A beneficiary generally does not have the power to revoke a trust. However, the trust may be a resource of the beneficiary, in the rare instance, where he/she has

³⁸POMS S.I. 01120.200.

³⁹POMS S.I. 01120.200.B.1.

⁴⁰POMS S.I. 01120.200.B.10.

⁴¹POMS S.I. 01120.200.B.12.

⁴²POMS S.I. 01120.D(3).

the authority under the trust to direct the use of the trust principal. (The authority to control the trust principal may be either specific trust provisions allowing the beneficiary to act on his/her own or by ordering actions by the trustee.) In such a case, the beneficiary's equitable ownership in the trust principal and his/her ability to use it for support and maintenance means it is a resource."⁴³ This would apply to a support trust where the beneficiary would have the right to compel distributions from the trust to or on behalf of the beneficiary.

Revocation becomes an issue in a self-settled special needs trust. Under Social Security law if the trust fails to name a residual beneficiary, Social Security maintains that the lifetime beneficiary has the authority to revoke the trust. If a trust fails to name a specific residual beneficiary, but rather names "heirs at law and next of kin" or refers to the state intestacy statute a problem may arise. Social Security follows state law to determine whether this language is sufficient to prevent the lifetime beneficiary from revoking the trust. Many states continue to follow the Doctrine of Worthier Title. Under this doctrine if the trust names as residual beneficiaries only heirs at law and next of kin or refers to the intestacy statute, the lifetime beneficiary has a right to revoke the trust. In those states the Social Security Administration will determine that the trust is revocable and, therefore, the assets in the trust are available and render the beneficiary ineligible for SSI.

f. Availability

Thus, the POMS recognize a two-pronged test for purposes of determining "availability." If the beneficiary of the trust has no right to revoke the trust or to direct the use of the trust assets for his/her own support and maintenance, then the trust principal is not the individual's resource for SSI purposes.⁴⁴

The revocability of a trust and the ability to direct the use of the trust principal depends on the terms of the trust agreement and/or on state law. If a trust is irrevocable by its terms and under state law cannot be used by an individual for support and maintenance, it is not a resource.

This is really the legal basis for a special needs trust.

3. Disbursements From Trust

A special needs trust must be properly drafted and funded, but it is crucial that it also be properly administered. These rules apply equally whether the trust is a third-party special needs trust or a self-settled special needs trust. Improper distributions from a properly-drafted and funded trust can cause the loss of public benefits to the beneficiary of the trust.

⁴³POMS S.I. 01120.200.D.1.b. Beneficiary.

⁴⁴POMS S.I. 01120.200.D.2.

a. Income

"If the trust principal is not a resource, disbursements from the trust may be income to the SSI recipient beneficiary, depending on the nature of the disbursements. Regular rules to determine when income is available apply."⁴⁵

"Cash paid directly from the trust to an individual is unearned income."⁴⁶ Therefore, it is crucial for the trustee of a special needs trust to have a clear understanding of the SSI income rules and to limit distributions to those expenditures which are appropriate.

"Disbursements from the trust by the trustee to a third party that result in the individual receiving items that are not food or shelter are not income."⁴⁷

b. In-kind support and maintenance

Disbursements which result in Receipt of In-kind Support and Maintenance are defined as food or shelter received as a result of disbursements from the trust by the trustee to a third party in the form of in-kind support and maintenance and are valued under the presumed maximum value (PMV) rule.⁴⁸ It is often appropriate to make ISM payments and for the beneficiary to have a reduction in benefits. Therefore, a trust document might contain language authorizing the trustee to make distributions for "food and/or shelter" for the beneficiary. The SSI monthly payment may be inadequate to provide the appropriate level of food and shelter for the beneficiary. As long as the SSI payment is maintained, although at a reduced level, Medicaid eligibility is maintained.

c. Third party non-income payments

Since these distributions do not result in any reduction of SSI benefit, they are the most desirable types of distributions for a trustee to make. It is important that the distributions be made directly to the third party, not to the trust beneficiary. "Disbursements from the trust by the trustee to a third party that result in the individual receiving items that are not food or shelter are not income. For example, if trust funds are paid to a provider of medical services for care rendered to the individual, the disbursements are not income for SSI purposes."⁴⁹

These rules are the basic rules for trust administration and define what distributions can be made from a trust, and what the impact of such distributions is on the SSI benefit of the trust beneficiary. It is crucial that trustees are aware of these rules.

⁴⁵POMS S.I. 01120.200.E.1.

⁴⁶POMS S.I. 01120.200.E.1.a.

⁴⁷*Id.*

⁴⁸POMS S.I. 01120.200E.1.b.

⁴⁹POMS S.I. 01120.200.E.1.c.

d. Home ownership

If a third party special needs trust owns a house used as a home for the beneficiary, the house is not a resource to the beneficiary.⁵⁰ SSA considers the beneficiary to have an “equitable ownership under a trust.”

The beneficiary living in the home is **not** considered to be receiving in-kind support and maintenance in the form of rent-free shelter because he/she has an ownership interest.⁵¹ However, the purchase of the home by the trust results in ISM for the month in which the purchase is made. The ISM is valued at no more than the presumed maximum value (PMV).⁵² If the home is purchased subject to a mortgage, each mortgage payment constitutes ISM.⁵³

Payment of household operating expenses by the trust constitute ISM. These include improvements or renovations, including those renovations needed to make the home handicapped accessible. But, improvements which increase the value of the home are not considered operating expenses and do not constitute ISM.⁵⁴

D. CASES

The key issue is whether or not the funds in the trust are "available" to the beneficiary.

1. Support Trusts

The typical trust which a parent creates for a child is known as a support trust. The trust usually contains language that the funds in the trusts are to be used by the trustee for the beneficiary's "health, education and support," "health, education and welfare," "health and support," "comfort and support," or similar language. It is clearly the intention of the settlor of such a trust that the monies be used to support the beneficiary of the trust. Support generally includes food, shelter, and medical care. Assets in such a trust are clearly "available" to the beneficiary.

2. Purely Discretionary Trusts

A trust can be drafted which gives the Trustee absolute discretion as to payment of income and/or principal to a beneficiary. This is a purely discretionary trust. In some cases, courts have held that the discretion of the trustee must be exercised in a reasonable manner to accomplish rather than thwart the purpose of the trust. These cases, again, revolve around the intention of the testator/settlor.

⁵⁰POMS S.I. 01120.200.F.1.

⁵¹POMS S.I. 01120.200.F.2.

⁵²POMS S.I. 01120.200.F.3.a.

⁵³POMS S.I. 01120.200.F.3.b.

⁵⁴POMS S.I. 01120.200.F.3.c.

3. Discretionary Support Trusts

A discretionary support trust is a hybrid between a support trust and a purely discretionary trust. The trust is drawn in such a way as to give the trustee the discretion as to whether or not to use income and/or principal for the support of the beneficiary. The issue is whether or not such trust assets are available. As always, courts interpret such trust provisions based on the intention of the trust's settlor.

Pennsylvania has a series of cases which illustrate the difficulty of predicting outcomes where a discretionary support trust is used. There are five cases. In three cases, the court held the trust assets to be available,⁵⁵ in two unavailable.⁵⁶

E. TRANSFERS & TRUSTS

The key to understanding the rules on trusts is to understand when the transfer has taken place.

1. Is the Asset Available After the Transfer?

If there is a transfer from an individual to a trust under conditions by which the trust assets are still available to the individual, there has been no transfer. Therefore, where the trust is revocable, the assets are still available to the individual after the trust is funded so there is no transfer at this point. The transfer is considered to have taken place on the date of payment from the trust to the third party.

If the trust is irrevocable, the transfer is considered to have been made as of the date the trust was established, or upon such later date that payment to the Settlor was foreclosed. However, if the Settlor can still benefit from the assets with which the trust is funded, those assets are still available so there is no transfer. If and when those assets are paid out to a third party, the transfer occurs. If the Settlor places assets in an irrevocable trust and can no longer benefit from any of the trust corpus, there has been a transfer of assets when the trust is funded.⁵⁷

The regulations pertaining to trusts under OBRA-93 are found in HCFA Transmittal 64.⁵⁸ A trust is defined as including any legal instrument or device that is similar to a trust, but not including testamentary trusts.⁵⁹ The individual is considered to have established the trust, if the individual's assets were used to fund the trust, and if the trust was established by the individual, the individual's spouse, a person, including a court or administrative body, acting on behalf of the individual or the individual's spouse, or a person, including a court or administrative body, acting at the direction of the individual or the individual's spouse.

⁵⁵*Commonwealth Bank and Trust Co. v. Commonwealth of Pennsylvania Dept. of Public Welfare*, 528 Pa. 482, 598 A.2d 1279 (1991); *Rosenberg v. Dept. of Public Welfare*, 679 A.2d 767, 545 Pa. 27 (1996); *Shaak v. Dept. of Public Welfare*, 707 A.2d 1199 (Pa. Cmwlth March 2, 1998) (1999).

⁵⁶*Lang v. Commonwealth Dept. of Public Welfare*, 528 A.2d 1335, 515 Pa. 428 (1987); *Snyder v. Commonwealth of Pennsylvania Dept. of Public Welfare*, 598 A.2d 1283, 528 Pa. 491 (1991).

⁵⁷HCFA Transmittal 64 § 3258.4E; 42 U.S.C. § 1396p(c)(1)(B).

⁵⁸HCFA Transmittal 64 § 3259.

⁵⁹42 U.S.C. § 1396p(d)(6); HCFA Transmittal 64 § 3259.1A1.

2. Revocable Trusts⁶⁰

The entire corpus of the trust is an available resource. Payments **to** the trust are not transfers, because the assets remain available. Payments to or for the benefit of the individual are counted as income. Payments **from** the trust to third parties are considered transfers. The lookback period is 60 months.

3. Irrevocable Retained Interest Trusts⁶¹

a. Payments

Payments from income or from principal paid to or for the benefit of the individual are treated as income.

b. Available income

If income could be paid for the benefit of the individual, it is treated as an available resource.

c. Available corpus

Any portion of the corpus that could be paid to or for the benefit of the individual is treated as an available resource.

d. Lookback and transfer

This type of trust is the most confusing in understanding the lookback and transfer rules.

e. Available portion of corpus

To the extent that a portion of the trust corpus is available to the individual, there has been no transfer and there would be no applicable lookback. If assets are transferred **from** the trust to a third party from the available portion, the lookback period is three years. This is inconsistent with the theory which makes transfers from an available revocable trust subject to a five-year lookback, but it is the HCFA interpretation, nevertheless.

f. Corpus unavailable

Where a transfer has been made **to** an irrevocable trust and the corpus of the trust is unavailable to the Settlor, the lookback period is five years. Transfers **from** the trust assets,

⁶⁰HCFA Transmittal 64 § 3259.6A.

⁶¹HCFA Transmittal 64 § 3259.6.

which were unavailable to the Settlor, are not considered transfers and there is no applicable lookback period.

4. Calculation of penalty

It is important to remember that although the transfers to and from trusts are usually subject to a five-year lookback, the penalty is calculated in the normal manner. Therefore, if a person transfers \$60,000 to an irrevocable non-retained interest trust and if the average cost of a nursing home in that particular state is \$6,000 per month, the penalty is ten months ($\$60,000 \div \$6,000 = 10$).

F. OBRA-93 TRUSTS

1. Income Only Trusts

a. Background

Income only trusts are a means by which persons may transfer assets to a trust rather than to their children. Seniors tend to view transfers to trusts as protection while they tend to view transfers to children as gifts. Trusts provide them with a sense of dignity and security. Income only trusts are permitted by OBRA-93.⁶² Income only trusts must be irrevocable.

The requirements for Income Only Trusts were spelled out in letters from Sally K. Richardson, Director Medicaid Bureau, Health Care Financing Administration, Department of Health and Human Services to Elice Fatoullah, dated December 23, 1993, the Elder Law Report, Volume V, Number 7, Page 2 and from Robert A. Streimer, Director, Disabled and Elderly Health Programs Group at HCFA's Center for Medicaid and State Operations to Dana E. Rozansky, dated February 25, 1998, The ElderLaw Report, Vol. IX, Number 9, April 1998, page 9.

b. Trust Design

(1) Income

The trust may provide that income shall be distributed to the grantor or may be distributed to the grantor at the discretion of the trustee. From a Medicaid standpoint, it is better to permit the trustee to use discretion in distributing income. From an income tax standpoint, it is usually better to distribute the income to the grantor to avoid income tax at the trust's highly-compressed tax rates.

(2) Principal

There can be absolutely no access to principal by either the grantor or the grantor's spouse. If either the grantor or his spouse has access to principal, the assets in the trust would be "available" for Medicaid eligibility purposes.

⁶²42 U.S.C. § 1396p(d)(3)(B).

(3) Principal distribution provisions

The trust should be designed to permit the trustee to make distributions to third parties. Through this mechanism, the trustee can stop income payments to a grantor who will be requiring Medicaid and can avoid estate recovery in those states which use a broad definition of "estate." The disadvantage to distributing the assets from the income only trust is that the opportunity for a "step up" in basis will be lost.

Care must be taken in considering whether to authorize the trustee to make distributions of trust principal to himself. Authorization of such distributions would be considered a general power of appointment held by the trustee. If the trustee predeceases the grantor, the value of the trust assets could be included in the estate of the trustee for federal estate tax purposes.

2. Under 65 Disability Trust

a. General provisions

These trusts are authorized under OBRA-93 and are funded with assets of the disabled person.⁶³ They are for the benefit of the disabled person. The person must be under 65 at the inception of the trust. Transfers to and from the trust are not subject to the transfer of assets rules. The trust should be drafted so that the resources are unavailable. The trust should be administered in such a way that the income is not counted as income to the beneficiary.

b. Medicaid consequences

(1) Establishment

The trusts must be established by a parent, a grandparent, legal guardian, or court. Curiously, they cannot be established by the disabled individual. Many judges are reluctant to establish a self-settled special needs trust absent state legislation conferring this authority. States such as Pennsylvania and Massachusetts have no such legislation at the present time. Where the court does establish the trust it need not sign the document as grantor. The establishment can take place through the court order. Social Security has also challenged a parent's right to establish a trust. Absent a valid power of attorney from the beneficiary to the parent authorizing the establishment of the trust, Social Security requires that the parent/grantor have an interest in the trust. A solution is to have the parent fund the trust with \$10. Whether or not a guardian has the authority to establish such a trust is dependent on state law.

(2) Distribution

The trust must provide that on death the funds remaining in the trust go first to reimburse Medicaid and then for the benefit of other beneficiaries.

⁶³42 U.S.C. § 1396p(d)(4)(A).

(3) Types of payments

OBRA-93 contains no expressed limitation on the amount or types of payments. However, it may be wise to limit payments to "in-kind" payments to cover goods and services other than food and shelter. These payments do not reduce public assistance. In-kind provision of food and shelter is treated as in-kind support and maintenance (ISM) and reduce the SSI benefit to the recipient.

(4) Age

While the trust must be established and funded prior to the beneficiary attaining the age of 65, it may be extended after 65. If the trust is funded with a structured settlement prior to the beneficiary attaining the age of 65, the trust remains viable even though payments from the annuity are received after age 65.

(5) Alternative

An attractive alternative to an under 65 trust is to transfer the assets to a trusted family member. If the disabled person is not receiving an institutional level of care, the Medicaid transfer of asset penalty may not apply. The family member would then provide "in-kind support." Parents or siblings may establish a special needs trust for the disabled adult child. In this manner, assets are preserved for inheritance rather than used to reimburse Medicaid.

(6) In-kind support

In-kind support consists of goods or services from third parties. They cannot include food or shelter, or anything that could be used to obtain food or shelter. If in-kind support does include food or shelter, then there may be a reduction of up to one-third of the SSI benefit if the beneficiary is living with another, or one-third of the benefit plus \$20 if the beneficiary is living alone.

3. Pooled trust

Pooled Trust—a trust which must be established and managed by a non-profit organization are authorized under OBRA-93.⁶⁴ These trusts are funded with the assets of a disabled person. The SSI definition of "disability" is used. There must be a separate account for each beneficiary. Funds are pooled for investment and management. The account is solely for the benefit of the disabled individual. A person can be over 65 at the time of the establishment of a trust. A disabled person can establish his own trust. On death, the funds remaining in the Pooled Trust must be retained by the trust or reimburse Medicaid.

There is no expressed limit on the amount or type of payment. It may be wise to limit payments to "in-kind" payments. In-kind payments do not reduce public assistance.

⁶⁴42 U.S.C. § 1396p(d)(4)(C).

An advantage of a pooled trust is that corpus is not counted as an asset. Also, a Community Trust already exists and does not have to be created. The Community Trust requires only a joinder agreement.

Transfers into a Pooled Trust by a person 65 or under are exempt from the lookback provisions and transfer penalties.⁶⁵ Transfers into a Pooled Trust by persons over 65 are subject to a three-year lookback.⁶⁶

The grantor trust rules apply and therefore the income tax is paid by the grantor at the grantor's rates. The trustee must track each sub-account. Gift tax issues must also be explored. If there is a *pooled* income fund, the remainder interest may be tax deductible.

4. Miller trusts

Under the Social Security Act, states are permitted to limit eligibility for nursing home care to those applicants whose income does not exceed 300 percent of the current Supplemental Security Income (SSI) benefit level.⁶⁷ Income for Medicaid purposes is defined as income for SSI purposes.⁶⁸ In 1990, the Colorado Federal District Court in *Miller v. Ibarra*⁶⁹ held that an individual may assign income to an irrevocable trust in order to reduce their income below the Medicaid income cap and obtain Medicaid eligibility. OBRA-93 incorporated the concept of the Miller trust and gave statutory authority under federal law for such trusts.⁷⁰ These trusts are also known as qualified income trusts or income assignment trusts. To be valid, a Miller trust must:

- Be composed only of pension, Social Security and other income to the individual, and accumulated income in that trust;
- The state must receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total Medicaid assistance paid on behalf of the individual under a state plan; and
- The state must have an income cap of 300 percent of the SSI benefit, and does not have a Medically Needy program.

Transfer penalty provisions of section 1917(c) do not apply to Miller trusts to the extent the income paid out is used for medical care, including nursing facility care and care under a home and community-based waiver. For example, if an individual in an income cap state had monthly income of \$1,756 per month in 2003 he would be \$100 over the income cap for Medicaid eligibility. However, if the individual assigned \$120 of his Social Security and/or pension income to a Miller trust, he would be \$20 under the income cap and would be income eligible for Medicaid. Miller trusts are not used in states that do not have an income cap and cannot be used in states that have "medically needy" program.

⁶⁵42 U.S.C. § 1396(p)(d)(4).

⁶⁶"Set Up Pooled Disability Trust," *The Elder Law Report*, Vol. V, No. 5, 8 (December 1993).

⁶⁷42 U.S.C. §§ 1396a(A)(10)(A)(ii)(v) and 1396f(4)(C).

⁶⁸20 C.F.R. § 435.601.

⁶⁹*Miller v. Ibarra*, 746 F. Supp. 19 (D. Colo. 1990).

⁷⁰42 U.S.C. § 1396p(d)(4)(B).

5. "Sole Benefit Of" Trusts

a. The concept

A "sole benefit of" trust is a creature of HCFA Transmittal 64.⁷¹ These trusts have traditionally been used in crisis planning. They can be established for the benefit of the community spouse, i.e., Spousal Annuity Trusts (SAT), or for the benefit of disabled persons, a Disability Annuity Trust (DAT). The idea is that such trusts would work very much in the same way as a commercial annuity. HCFA Transmittal 64 also establishes the rules for the use of commercial annuities in Medicaid planning.⁷² The idea is that assets would be transferred to an irrevocable trust for the sole benefit of the community spouse or disabled individual. The assets in the trust were then paid out to the beneficiary on an actuarially sound basis using the actuarial tables contained in HCFA Transmittal 64.⁷³ Because the assets were transferred to an irrevocable trust "for the sole benefit of" a spouse or disabled individual, the transfer is not subject to the transfer penalty rules. This is a particularly useful device where (1) there are highly-appreciated assets and utilization of the trust makes it possible for a "step up" in basis to be obtained, (2) there is a married couple with no children or no children who are trustworthy, and (3) advanced planning has not been done and the transfer of assets to children would result in significant periods of Medicaid ineligibility. There are two issues to be considered in utilizing "for the sole benefit of" trusts. These issues are transfer rules and availability.

b. Definition of "sole benefit of"

HCFA Transmittal 64 deals with transfers of assets and treatment of trusts.⁷⁴ "For the sole benefit of" is defined.⁷⁵ A transfer is considered to be for the sole benefit of a spouse, blind or disabled child, or a disabled individual if the transfer is arranged in such a way that no individual or entity except for the spouse, blind or disabled child, or disabled individual can benefit from the assets transferred in any way, whether at the time of the transfer or at any time in the future. For a transfer or trust to be considered for *the sole benefit of* one of these individuals, the instrument or document must provide for distribution to or for the benefit of the disabled individual on an *actuarially-sound basis* predicated on the life expectancy of the individual involved. Since this is an exempt transfer, no penalty is imposed. It is important to note that the trust can be established for any disabled individual. The disabled individual does not necessarily have to be a child.

Some state Medicaid agencies do not follow HCFA Transmittal 64 and require a payback provision. This appears to violate federal law.

⁷¹HCFA Transmittal 64 § 3257.

⁷²HCFA Transmittal 64 § 3258.9B.

⁷³*Id.*

⁷⁴HCFA Transmittal 64 § 3257.

⁷⁵HCFA Transmittal 64 § 3257(B)(6).

c. Transfer penalty

HCFA Transmittal 64 states that transfers for the sole benefit of a spouse and transfers from a spouse to a third party for the sole benefit of the spouse are exempt transfers.

d. Availability

The key issue concerning trusts "for the sole benefit of" is availability. In a recent private letter, the Health Care Financing Administration has taken the position that a trust established for the sole benefit of a community spouse under HCFA Transmittal 64 is an available resource.⁷⁶ It should be noted that the letter from HCFA is not law. It is not a statute, it is not a regulation, it is not policy.

e. Estate recovery

It would appear that the assets contained in a Spousal Annuity Trust are not subject to estate recovery. In jurisdictions limiting estate recovery to assets of the probate estate, the assets in the trust clearly are beyond the probate estate. In states using the broad definition of an estate, it would be argued that the deceased Medicaid recipient, i.e., the institutionalized spouse, had no legal interest in the trust at the time of death. Therefore, even under the broad definition of an estate, the assets contained in the Spousal Annuity Trust should not be subject to estate recovery. However, if the state uses a tracing argument estate recovery may apply.

6. Disability Annuity Trusts

A Disability Annuity Trust can be established for a disabled child or any disabled individual.⁷⁷ However, in considering the use of an annuity trust for a disabled person, care must be taken to examine the other government benefits currently being received, or which may in the future be received, by the person with disabilities.

If the person is receiving SSI, that person also receives Medicaid. SSI is a means-based program. Both resources and income are considered in determining eligibility. If the person with disabilities receives distributions from the annuity trust, this may well disqualify that person from receiving SSI and cause a loss of Medicaid. If a Disability Annuity Trust is designed as a Special Needs Trust, public benefits may be preserved.

If the person with disabilities is receiving SSD, this is usually accompanied by Medicare. SSD and Medicare are insurance-based programs, rather than means-based programs. Receipt of income from the annuity trust would not cause a loss of SSD or Medicare. However, consideration should be given to other benefits, which the person with disabilities may receive in the future. For example, will the person with disabilities be a candidate for group housing in the future? If so, the existence of the annuity trust may cause them to lose that benefit.

⁷⁶Letter dated April 16, 1998 from Robert A. Streimer, Disabled and Elderly Health Programs Group, Center for Medicaid and State Operations, Health Care Financing Administration, to Jean Galloway Ball.

⁷⁷HCFA Transmittal 64 § 3257(B)(6).

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