

Kimball, Tirey & St. John LLP

Special Needs Trusts

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A Special Needs Trust is a legal document that creates a separate entity called a "Trust." The Trust is designed to hold and spend funds for someone who is receiving government financial assistance that has limits on assets the person can have (generally SSI and some forms of Medi-Cal, or Medicaid in other states.) Many government assistance programs require that the person receiving aid have no more than about \$2,000.00 in assets. The government requires that Special Needs Trusts comply with applicable laws and program regulations. Special Needs Trusts have been used for several years, and are now recognized by Federal and California laws.

FIRST PARTY VS. THIRD PARTY SPECIAL NEEDS TRUSTS

There are two major types of Special Needs Trusts:

- (1) First Party Special Needs Trusts that contain the disabled person's own money (such as when a parent neglects to plan in advance and leaves an inheritance, or for lawsuit settlements), and
- (2) Third Party Special Needs Trusts set up with third-party funds that have never legally belonged to the person.

First Party (or "self-settled") Special Needs Trusts are far more complicated. They often, but not always, require ongoing court proceedings, notice to government entities, government pay-back provisions on death, and regular accountings to the Court. As a result, these are more expensive and difficult to set up and administer, but they are still usually better than losing program eligibility. Sometimes, for smaller amounts, it is possible to use a "pooled" Special Needs Trust, set up by a nonprofit entity that administers individual subtrusts as a unit for administrative purposes.

Only First Party (self-settled) Special Needs Trusts require a provision to repay the state for benefits when the person dies or the Trust terminates. Third Party Special Needs Trusts are not required to have provisions for repayment to the government. However, it is usually not possible for the disabled person to simply turn down or retransfer an inheritance after someone dies, since that is considered an illegal gift. As a result, if a parent or someone else wants to provide funds that can be used for a disabled person who is receiving government benefits, without repayment provisions, it generally must be done through a Third Party Special Needs Trust, as part of that person's estate planning process and documents.

WHAT SPECIAL RULES GOVERN THIRD PARTY SPECIAL NEEDS TRUSTS?

There are actually few rules governing Third Party Special Needs Trusts. If the disabled person is never legally entitled to the money in the Trust, the most important rule is simple: the Trust terms cannot automatically entitle the person to either income or principal. As long as the trustee has complete discretion about whether or not to make distributions, the Trust should not disqualify the person from benefits.

To avoid loss of a disabled child's government benefits, the only generally safe alternative to using a Special Needs Trust is to completely disinherit the child, or leave the child only minimal exempt assets. The disabled child cannot receive gifts, or be the beneficiary of life insurance policies, retirement plans, IRAs, etc. This is often combined with giving extra funds to other children to "take care of" the disabled child. Because of the other children's debts, divorces, and other financial needs, as well as simple human nature and sibling relationship problems, this seldom works out as well as the parents expect.

A properly drafted and administered Third Party Special Needs Trust set up by a third party such as a parent can create a fund that can be used to pay for the things that the government programs do not cover, such as dental care, trips, entertainment, transportation, education, and the like. It can hold an unlimited amount, and can invest in all types of assets, without those assets being considered disqualifying assets of the disabled person. The trust has its own tax identification number and files its own tax returns, avoiding the use of the disabled person's Social Security number for the income it earns.

The Trustee can be a sibling, a family friend, or a professional trustee. Using a neutral licensed professional trustee often helps prevent family friction and fights between the disabled person and the family member controlling the funds, and helps ensure that the funds are not used in way that would affect the person's eligibility.

For all estate planning documents, it is important to use a qualified professional who knows the rules to set up the paperwork. The attorneys at Kimball, Tirey & St. John are available to assist you in this complex but important area of the law. If you have questions regarding this article, please contact Charles Scott at (800) 574-5587 or charles.scott@kts-law.com.

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