

# Special-Needs Trusts

Special-Needs Trusts are vital tools in settling personal injury cases. An injured client will often require a sophisticated level of medical care for the remainder of his or her life. A properly drafted and maintained Special-Needs Trust allows the disabled client to enjoy the settlement proceeds for certain special needs, while maintaining eligibility for vital, and otherwise expensive, health care benefits through Medicare and Medicaid.

A Special-Needs Trust for the benefit of a disabled child can also be a method to render a parent a disabled trust beneficiary eligible for Medicaid benefits, while precluding the trust principal from being considered a resource for determining the trust Beneficiary's eligibility for Social Security Income benefits.

On June 5, 2000, the New Jersey Division of Medical Assistance and Health Services issued proposed regulations governing the Treatments of Trusts for Medicaid Only applicants. The new regulations, which were effective June 18, 2001, were scheduled for adoption and publication in the June 18, 2001 New Jersey Register.

New section N.J.A.C. 10:71-4.11 (g) et seq., is intended to conform state regulations to current Federal law regarding trusts for disabled persons and the transfer of asset penalties associated with Special-Needs trusts. Under the new regulations, there are six separate instances in which the Trustee is required to give notice to various agencies at the County and State levels. Moreover, if the trust beneficiary is an incapacitated adult, the Trustee must also comply with the court rules and statutes governing guardians. As a result, the regulations require a minimum of five annual filings with County, State and Federal entities.

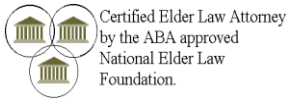
This article assumes that all liens have been paid prior to funding the Special-Needs Trust and that the trust has been drafted in accordance with N.J.A.C. 10:71-4.11 (g). The goal of this article is to outline the practical follow through needed to obtain the benefit intended at the establishment of the Trust. Practitioners should use this article as a tool in advising potential Trustees of a Special-Needs Trust.

Due to the complexity in managing a Special-Needs Trust, and the substantial federal and state oversight of such trusts, a client should retain an attorney and an accountant. If the Trustee fails to follow the rules embodied in the regulations, the trust Beneficiary, at the minimum, could lose his or her Social Security Income benefits and Medicare benefits. If a Trustee violates certain duties, as with any trustee, he or she could be exposed to personal liability. Finally, if the trust is funded as a result of a transfer for less than adequate consideration, which was made in order to render a parent of the disabled trust Beneficiary eligible for Medicaid benefits, such eligibility could be affected.

## Trustees Initial Checklist

Under the new regulations, the Trustee's first step, in the case of a minor or incapacitated adult trust beneficiary, is to obtain a surety bond, or a court order stating that the Trustee can act without bond. N.J.A.C. 10:71-4.11 (g)1(iv)(3) and N.J.A.C.

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10:71-4.11 (g)1(xi)(1). Therefore, as a practical matter, the Trustee must have an acceptable credit history.

The Trustee must also obtain a taxpayer identification number from the Internal Revenue Service for the Trust. A taxpayer identification number is obtained by completing IRS form SS-4. The taxpayer identification number can be obtained over the telephone. To establish trust accounts, the Trustee generally provides the taxpayer identification number and a copy of the trust to each financial institution. At this time it is wise to advise the client that maintaining accurate records of the trust accounts will be vitally important in order to insure the ongoing eligibility of the trust beneficiary for public benefits.

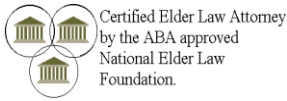
If the trust Beneficiary is an incompetent adult, N.J.A.C. 10:71-4.11 (g)1(xi)(1) requires the trust to specifically incorporate by reference of the guardianship protections required by New Jersey law and court rules. Under new guidelines each guardian, and hence the Trustee must prepare an initial “Annual Report of Guardian” and a formal or informal “Accounting” and submit the report to the County Surrogate. The initial Accounting must reflect the principal value of the assets distributed to the trust. In addition, the Trustee must submit an Inventory and initial Accounting of the assets transferred to trust to the County Board of Social Services, as required by N.J.A.C. 10:71-4.11(g)1(xvi). Since the regulations require the Trustee to submit an annual Accounting to both the Surrogate and the County Board of Social Services, an accurate initial Accounting will aid as an important benchmark in future Accountings.

### **Trustees Annual Checklist**

As discussed above, an informal or formal Accounting must be filed with the County Board of Social Services on an annual basis. Hypothetically, County employees will review the submissions, including individual disbursements from the Special-Needs Trust, to determine whether they are on behalf of food, shelter, or clothing, and, if so, to impose applicable penalties on the Trustee, Grantor, or the Beneficiary. Moreover, as addressed further below, N.J.A.C. 10:71-4.11(g) seeks to prohibit the Trustee from using the trust assets in any way that would confer a substantial and ongoing benefit to a third party. Therefore, County workers may examine trust distributions to determine whether the trust is conferring a benefit on a third party, without the trust being reimbursed.

If the beneficiary is an incapacitated adult, there are additional annual requirements imposed on the Trustee. By requiring the incorporation of the protections afforded incapacitated persons under New Jersey’s guardianship laws into the Special-Needs Trust, N.J.A.C. 10:71-4.11 (g)1(xi)(1) requires the Trustee to file an Accounting and Annual Report with the appropriate County Surrogate. The form of the annual report can be obtained through the Surrogate. In order to adequately complete the Annual Report, the Trustee must contact and obtain medical information from professionals who are responsible for the trust beneficiary's care.

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Finally, a Special-Needs Trust is generally considered a “grantor” trust for income tax purposes. The Trustee must file annual Federal and State income tax returns on behalf of the trust.

Excellent record keeping and proper professional advice is necessary in order for Trustees to comply with the regulations. The annual duties of filing state and federal income tax returns, accounting to the County Surrogate and Board of Social Services, and preparing an Annual Guardian’s Report, are threshold requirements for the proper management of a Special-Needs Trust under the new regulations. The remainder of this article will address the numerous additional requirements imposed on Trustees.

## Trustees General Checklist

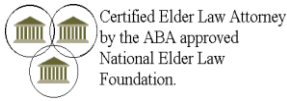
Under N.J.A.C. 10:71-4.11(g)1(ii.), a Special-Needs Trust must specifically state that it is for the sole benefit of the trust beneficiary. That means that no one, other than the primary beneficiary, can receive distributions from the trust. Note, however, that this limitation does not apply to trustees commissions (only as provided by N.J.S.A. 3B: 18-1 et seq.). N.J.A.C. 10:71-4.11 (g)1(xi)

In order to reinforce the “sole benefit” requirement, subsection (A) of N.J.A.C. 10:71-4.11(g)1(ii.) seeks to prevent Trustees from using trust funds to confer an “ongoing and continuing” benefit on a third party by requiring the Trustee to obtain a reimbursement from third parties who have received such benefits from the trust. Likewise, N.J.A.C. 10:71-4.11(g)1 (ii.)(A) deems that any property acquired by the trust shall be titled solely in the trust's name. In addition, the same section prohibits the trust from paying for upkeep, property taxes, or other expenses associated with real property used by the beneficiary, or any additions to the existing property, unless the trust is given equity in any improvements to the property. Id.

One exception to the Medicaid transfer penalties allows a parent to literally transfer an unlimited amount of assets to a Special-Needs Trust for the benefit of a disabled child under 65, without the imposition of a penalty. If one purpose for establishing the Special-Needs trust was to quickly render a parent eligible for public benefits, and the trust then confers a benefit on a third party, arguably the penalty free status of the original conveyance to the trust could be revoked.

Prohibited trust distributions, including providing food, clothing, or shelter to the primary Beneficiary are considered income under Social Security and Medicaid eligibility rules. Such income is a major factor in determining an individual’s eligibility for SSI benefits and, if eligible, in computing the amount of his or her benefits. SSI benefits generally decrease to the extent that an individual receives more income. Accordingly, an individual who has too much income is not eligible for SSI benefits.

Finally, be sure to advise the Trustee of the limitation contained in N.J.A.C. 10:71-4.11(g)1(xv), which permits the trust to provide for a prepaid burial plan before the death of the primary beneficiary, but bars the Trustee from paying for reasonable burial expenses after the death of the trust Beneficiary.



## **Events Required to be Reported to the County Board of Social Services**

The notice requirements contained in the new regulations are quite specific, and the Trustee must be very careful to notify the correct entity in a specific circumstance.

The County Board of Social Services is responsible for determining the eligibility of new applicants for public benefits, and for the ongoing re-determination of a beneficiary's eligibility for public benefits. Under N.J.A.C. 10:71-4.11(g)1(v)(1), the Board of Social Services must be advised when additional assets are added to the trust. However, no contributions can be made to the trust after the trust beneficiary reaches age 65, or the contribution shall be subject to transfer of resource penalties. Id.

## **Events Required to be Reported to the Department of Human Services, Division of Medical Assistance, and Health Services**

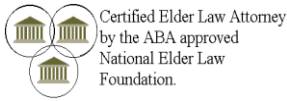
The Division of Medical Assistance and Health Services is a subdivision of the New Jersey Department of Human Services. Generally, County Social Service Boards follow policies determined at the State level. However, the regulations treat the State and County entities separately.

Under N.J.A.C. 10:71-4.11(g)1(xvii), the Division of Medical Assistance and Health Services must be given advanced notice of all expenditures from the trust in excess of \$5,000, and notice of the expenditure of *any* amount that would substantially deplete the principal of the trust. Written Notice must be provided 45 days prior to the proposed expenditure, and must be forwarded to the Division of Medical Assistance and Health Services, Bureau of Administrative Control, at PO Box 712, Mail Code 6, Trenton, New Jersey 08625-0712.

N.J.A.C. 10:71-4.11(g)1(x) requires the trust to state that the Trustee must comply with the Prudent Investor Act, N.J.S.A. 3B: 20-11.1 et seq., and is prohibited from taking any actions not authorized by, or without regard to, State laws. Therefore, the Division of Medical Assistance and Health Services must be advised, in writing, if the trust gives the Trustee any power not contained in the Prudent Investor Act and an explanation for each power.

Since the regulations require that the State of New Jersey shall be paid all amounts remaining in the Trust up to the total value of all medical assistance paid on behalf of the beneficiary, the Division of Medical Assistance and Health Services must be notified of the death of the primary beneficiary. N.J.A.C. 10:71-4.11(g)1(xii). The Trust must state that the trustee shall comply fully with this obligation under the statute to first repay the State, without requiring the State to take any action except to establish the amount to be repaid. Id. Under the regulations, repayment shall be made to the Treasurer, State of New Jersey, and shall be sent to

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the Division of Medical Assistance and Health Services, to the attention of the Bureau of Administrative Control, PO Box 712, Trenton, New Jersey 08625-0712, or to any successor agency.

Finally, N.J.A.C. 10:71-4.11(g)1(ix) directs that the Division of Medical Assistance and Health Services must be notified prior to a change of Trustee.

### **Notice Requirements to Other State Medicaid Programs**

If the beneficiary has received Medicaid benefits in more than one state, the regulations require that each state that provided Medicaid benefits must be repaid upon the death of the beneficiary, but only after New Jersey is paid. N.J.A.C. 10:71-4.11(g)1(xiv). If there is an insufficient amount left to cover all benefits paid, then each state shall be paid its proportionate share of the amount left in the trust, based upon the amount of support provided to the beneficiary. Id.

### **Conclusion**

The Special-Needs Trust is derived from 42 U.S.C. 1396p, and is intended to effectuate public policy. The goal of that policy is to insure that young, disabled people have resources available, with limitation, to better their lives. In addition, the resources held in trusts do not adversely affect the beneficiaries' eligibility for benefits such as Social Security Income, Medicare, and Medicaid. Furthermore, since transfers of resources by a parent to a properly drafted Special-Needs Trust for the benefit of a child under the age of 65 results in exclusion from the Medicaid transfer penalties, such trusts can also further the goal of preserving family wealth. With the able assistance of an attorney and accountant, the many benefits of a Special-Needs Trust greatly outweigh the burdensome management requirements imposed on the Trustee by State regulations.