ESTATE PLANNING FOR THE DISABLED: AN OVERVIEW OF SPECIAL NEEDS TRUSTS

Steven M. Jankower
Attorney at Law
110 Exchange Place
Suite 101
Lafayette, LA 70503
(337) 289-1745

The front page of the May 14, 2001 issue of the Daily Advertiser contained several articles concerning bills currently being considered by Congress to provide tax relief to families with children with special needs. As the father of a nine-year-old Downs Syndrome child, the article was certainly of interest to me. The articles included statistics from the U. S. Census Bureau indicating that in 1990, 29.1 percent of Louisiana's under age 18 population was disabled. According to a July 1998 study reported in Pediatrics Journal, nationally, 18% of children under 18 years old (12.6 million children) in 1994 had chronic physical, developmental, behavioral or emotional conditions requiring special care.

As I found out shortly after my second daughter was born in 1992, the unusual medical expenses associated with having a disabled child can be quite significant. Since in many instances disabled children are not eligible for health insurance, public health programs such as Medicaid provide a lifeline for families trying to cope with such expenses. In Louisiana, for example, the Community Home-Based Waiver Program provides Medicaid and respite benefits to eligible families with disabled children without regard to need-based qualifications concerning the income and assets of the parents that are normally associated with Medicaid. These programs provide needed health coverage for special needs individuals that they often cannot obtain through private health insurance carriers, and also provide personal care attendants and babysitters to assist with these children.

However, qualifying for Medicaid through the community home-based waiver program can be a difficult and trying experience. Applicants for the program must meet stringent eligibility requirements. Applicants who are otherwise eligible are required to place their names on waiting lists and must usually wait for years until "slots" in the waiver program become open and available. According to the articles in the Daily Advertiser cited above, up to 10,000 people in Louisiana are currently on the waiting list to receive benefits under the program. Once slots open up, applicants must often be re-evaluated for a determination of continuing eligibility. If deemed ineligible, applicants are forced to pursue time-consuming, expensive, and repeated administrative appeals to contest eligibility. Even if applicants are able to secure slots for their children in the program, the continuation of benefits can be tenable as a result of available funding. While this process slowly proceeds, applicants may be forced to dig deeper in their pockets to pay for medical and related expenses that are not covered by private or group health plans.

Once eligibility has been established and benefits are being received, parents who have not properly planned their estates and those of their disabled children can find themselves instantly disqualified from the Medicaid waiver program as a result of the stringent eligibility requirements associated therewith. Specifically, these requirements include severe income and asset limitations for the special needs child that can cause otherwise eligible and deserving individuals to be disqualified. For example, under Medicaid rules, an individual receiving benefits can own no more than $2,000.00 in "qualifying assets". Where a special needs individual owns qualifying assets in excess of this amount, they can be immediately disqualified or their benefits can be curtailed for extended periods of time.

Even more troubling is the fact that disqualification from the program can occur without any steps being taken by the recipient to cause such. For example, a special needs child may have funds and/or other assets irrevocably donated to him through the Louisiana Uniform Transfers to Minors Act (La. R. S. 9:751, et seq.) by a well-meaning family member or relative unaware of Medicaid rules and limitations. The admirable and generous intentions of such family member or relative can cause the minor's qualifying assets to exceed $2,000.00, thereby disqualifying the special needs child from Medicaid and other benefits under the waiver program.

Children with special needs are not the only individuals who are vulnerable to the possibility of disqualification from public programs such as Medicaid if their parents have not properly planned. Elderly individuals who are in need of long-term care may also be eligible for Medicaid with proper planning. Disabled persons who have received or may receive personal injury settlements arising out of tort claims may also require proper planning in order to insure eligibility for Medicaid so that they can avoid having to exhaust their monetary settlements in order to obtain Medicaid. Unfortunately, because eligibility for Medicaid is directly linked to having no more than minimum levels of available income and resources, these persons can find themselves ineligible and/or disqualified from Medicaid unless they essentially impoverish themselves in order to become eligible. For individuals in these circumstances, a promptly drafted special needs trust document can be a useful tool in achieving and maintaining eligibility for Medicaid. With particular regard to settlement of personal injury claims involving disabled individuals who may be eligible for Medicaid, it is critical that attorneys fully consider and counsel their clients on the requirements for achieving and maintaining eligibility through use of these trusts.

Unfortunately, when dealing with making sure that a disabled family member can qualify for Medicaid and other similar governmental benefits programs, traditional estate planning techniques simply do not work, and in fact can be counterproductive. Leaving a traditional legacy to a disabled child or placing the same in trust for the benefit of such child without including stipulations limiting the use and access to such funds can cause the child to be disqualified from Medicaid. As a result, special estate planning techniques must be undertaken by families of disabled children in order to insure that long-term health coverage and long-term care through the Medicaid program can be maintained.

Medicaid is a federal program, but it is partially funded by the states, and is administered by the states. Medicaid rules are unusually and unnecessarily complicated, primarily because there is little jurisprudence interpreting the complex legislation and because the rules are constantly being amended and revised. Persons applying for such benefits must meet the definition of "disability" under the applicable definition, i.e., "inability to engage in substantial gainful employment due to a medically determinable physical or mental impairment that has lasted, or can be expected to last, for a continuous period of not less than 12 months". Medicaid eligibility is also based upon financial need and there are income and asset limitations that must be met in order to qualify for such

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programs. Assets in sufficient minimum amounts that are deemed to be "countable assets" for purposes of the programs can disqualify persons from Medicaid. These countable assets can include liquid assets, real estate, and other personal property that could be sold to provide for an individual's basic needs. Certain assets are exempted from being considered as "countable assets" under the rules. These assets include the claimant's principal place of residence, an automobile, and certain household goods and personal effects of limited financial value.

Families with disabled or special needs members are required to consider several options in evaluating how to achieve and maintain continuing eligibility for Medicaid. These options include the following:

(a) Disinheritance – In many states, families with disabled children can simply disinherit their children and avoid making any transfer of assets to the child by virtue of donations or testamentary legacies. This is probably the simplest alternative for making sure that such disabled family members continue to qualify for Medicaid and/or other governmental benefit programs. However, in Louisiana, this is not a realistic option. Louisiana Civil Code Article 1493 provides that forced heirs include "... descendants of the first degree of any age who, because of mental incapacity or physical infirmity, are permanently incapable of taking care of their persons or administering their estates at the time of the death of the decedent." Accordingly, as opposed to the limited forced heirship rules that now apply to children who are aged 23 and younger, children who are mentally or physically disabled and permanently incapable of taking care of themselves or of handling their affairs are deemed to be forced heirs for life.

(b) Gifting – While gifting sums of money directly to a disabled child can, in short term, help provide for their needs, the big problem is that gifting sums of money outright to a disabled family member of more than a nominal amount will undoubtedly disqualify such family member from Medicaid. This is true whether the gift is made inter vivos or by virtue of a testamentary disposition. This can become particularly important if parents or other persons inadvertently name a disabled person as a beneficiary under a life insurance policy or annuity. In my experience, I have also encountered circumstances where the efforts of a family to avoid outright gifting of funds to a disabled family member can be undone by a distant relative or family member who may altruistically attempt to gift or donate funds to the disabled individual without realizing that the consequences of doing so may be the reduction and/or outright disqualification of such individual from Medicaid and other need-based governmental programs.

(c) Transfer of funds to relatives or third parties to be used for the benefit of a disabled family member – This method of providing for a disabled family member can be very inexpensive and a quick way to avoid the counting of such assets as countable or available assets in a disabled individual's estate. However, such transfers can still be quite problematic for purposes of qualifying for programs such as Medicaid. The person to whom the funds are transferred generally has no legal duty to act in accordance with the transferor's wishes and arguably can dispose of the funds or assets in any way that he or she may deem appropriate. Any instructions given by the transferor to the transferee with regard to use of the funds for the benefit of a disabled individual may arguably constitute a "constructive trust" and cause the assets under the control of the third party to be "countable assets" for purposes of determining continuing eligibility for Medicaid benefits. Furthermore, assets held for the benefit of a disabled individual in the hands of a third party could become a part of such third party's estate and be subject to claims by creditors. The assets could form a part of such party's estate for purposes of computing the forced portion of his estate for his own heirs. The bottom line is that transference of funds to a third party for the benefit of a disabled individual creates no legal obligation on the part of the third party to use the funds as directed.

(d) Special needs trusts - The best option for persons desiring to provide for a disabled individual and insure that he or she remains eligible for Medicaid or other governmental assistance programs is the use of what is commonly known as a "special needs trust". These trusts, if careful drafted, can allow assets placed therein to avoid being counted as "available assets" of the disabled individual for purposes of determining Medicaid eligibility.

Of particular significance in evaluating this issue is the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). This was signed into law by former President Clinton on August 10th 1993 and amended the rules under the Medicaid program for treatment of asset transfers by applicants for the program. Specifically, the Act made revisions to 42 U.S.C. § 1396p regarding the determination of an individual's eligibility for Medicaid benefits under a trust set up by and/or for the benefit of such individual. The OBRA '93 provisions were designed to restrict individuals from attempting to transfer all of their assets to others and/or to trusts while remaining beneficiaries of such trusts in an effort to secure government paid long-term care services. Congress accomplished this by increasing the so-called "look back periods" during which Medicaid could look at transfers of assets made prior to application for benefits to determine eligibility, by restricting the ability of individuals receiving Medicaid to be beneficiaries of wealth sequestered in trust agreements, and by facilitating the ability of the state to recoup Medicaid funds expended during an individual's lifetime from his estate after death. However, the Act set forth two types of trusts created with an applicant's own assets that are not counted for Medicaid eligibility purposes. These are commonly known as the "under age 65 disability trust" and the "pooled account trust".

An "under age 65 disability trust" is one created by a parent, grandparent, legal guardian, or a court to hold a disabled individual's assets with the assets of others for the benefit of a disabled individual under the age of 65. Generally speaking, funds held in such a trust are not deemed to be countable assets for purposes of determining Medicaid eligibility provided that the trust contains language indicating that at the beneficiary's death, the state will receive amounts remaining in the trust up to the total amount of Medicaid benefits provided by the state during the lifetime of such individual. After the beneficiary reaches age 65, the assets in the trust are still not considered to be "countable assets" for purposes of determining Medicaid eligibility, but additional assets added to the trust after age 65 are deemed to be countable assets.

A "pooled account trust" is an account that is set up and handled by a non-profit association to hold the assets of disabled individuals in separate accounts. The trust does have the ability to pool the accounts for investment and management purposes. Separate accounts must be established by the beneficiary's parent, grandparent, legal guardian, or by a court. As is the case in the under age 65 disability trust, if any amount remains in the account at the time that the beneficiary dies, such amount must be paid to the state up to the total lifetime amount of Medicaid benefits paid to the beneficiary during his life.

These trusts can be a desirable method of making sure that an individual who does not have long-term care coverage qualifies for Medicaid without being forced to deplete his estate and personal assets in order to do so. However, the fact that provisions have to be included in such trusts requiring Medicaid to be

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reimbursed upon the beneficiary's death for the amounts spent by Medicaid during the beneficiary's life can counteract the desirability of such trusts. Obviously, it is more desirable for an individual to plan for the need for long-term care in advance through proper estate planning and procurement of long-term care insurance rather than being forced to place all of his assets in trust in order to attempt to offset the costs of long-term care through eligibility for a government benefit program such as Medicaid.

Finally, so called "third party special needs trusts" can be used. Where an inter vivos or testamentary trust is set up by a third party for the benefit of a disabled individual and is funded solely with the assets of such third party, and not with assets of the disabled individual, the assets should not be counted for purposes of determining the disabled individual's eligibility for Medicaid. However, this can depend upon the way that the trust is structured and the restriction on distributions to the beneficiary contained in the trust. To the extent that assets are deemed available to the beneficiary under the language of the trust document, such availability may still disqualify the beneficiary from eligibility for Medicaid benefits. Furthermore, if the trust document mandates that the assets be used to provide for basic or primary support for the beneficiary, the assets may be deemed to be countable assets for purposes of Medicaid.

As a result, it is important that the language included in a special needs trust be carefully drafted by an individual experienced in drafting such trusts in order to make sure that the assets are not deemed to be countable assets. Generally speaking, the purpose of the trust is to provide for supplemental needs that are not provided by other sources of assistance, including governmental assistance. The language in a special needs trust should specifically limit the discretion of the trustee to allow distributions for special needs of the beneficiary while prohibiting distributions for basic support, maintenance, welfare, and/or medical programs provided under governmental assistance programs. Where language containing these limitations on the use of trust funds is included in the trust, it should prevent a beneficiary from having the assets of the trust deemed as countable assets for purposes of Medicaid eligibility.

Since a disabled child is deemed to be a forced heir for life, rather than a limited forced heir, under Louisiana law, a special needs testamentary trust created under a parent's will to receive a disabled child's forced portion and insure continued Medicaid eligibility presents unique problems. Under La. R.S. 9:1841, the legitime can be placed in trust, provided that the trustee shall distribute to the forced heir or his legal guardian funds from the net income in trust sufficient for the health, maintenance, support and education of the forced heir, and the forced heir's interest is subject to no charges or conditions except as provided in subsequent sections of this section. However, a trust instrument can contain spendthrift stipulations and the legitime in trust can be burdened with an income interest or usufruct in favor of a surviving spouse. While there is a dearth of case law on this issue, it seems reasonable that to the extent that the forced portion can be satisfied with a life income interest in trust with no right of the trustee to invade principal, a special needs trust containing restrictions on distributions to and/or on behalf of a disabled family member should be proper.

Use of special needs trusts can also be particularly important in the settlement of tort claims involving disabled individuals. These trusts can be used to make sure that funds received in settlement of a personal injury claim do not have to be used exclusively to offset future medical bills that might have otherwise been covered by Medicaid in absence of the settlement. In order to make sure that such trusts are properly set up and included as a part of a settlement, several factors should be considered. First, an attorney seeking to use a special needs trust established to accept the proceeds of a personal injury claim should seek and obtain court approval to do so. It is also critical that funds paid in settlement of a claim be paid to the special needs trust, and not directly to the disabled plaintiff. Steps should be taken to make sure that any unpaid Medicaid liens are fully paid and satisfied prior to completion of the settlement. Further, care should be taken to select the proper trustee to administer the special needs trust on behalf of the disabled plaintiff. Any attorney unfamiliar with the establishment of special needs trusts should seek and obtain the assistance of an estate-planning attorney specifically familiar with the establishment of these trusts for disabled individuals.

Finally, it is important to note that while the trust provisions described above can be useful in insuring a disabled beneficiary's continuing qualification for Medicaid benefits, the rules governing Medicaid are in a constant state of flux. As a result, what may work today may not work tomorrow, or six months from now, or five years from now. As a result, it is critical that these trusts regularly be revisited and that any questions concerning the drafting and construction of such trusts be discussed with an attorney familiar with the constantly changing Medicaid rules.