

SPECIAL REPORT

Third Party Special Needs Trust

Thank you for contacting Oast & Hook for information concerning your estate planning and discussing your goal of securing the future for your disabled child. The purpose of this brochure is to give you an idea of what will be covered at the meeting and to start you thinking about some important decisions. At the meeting the attorney will go over everything very carefully and will assist you in understanding this process and answer questions you may have. Fortunately, disabled persons are living much longer than they used to. Unfortunately, they are outliving their parents and provision must be made for their future.

FIVE CHOICES FOR ESTATE PLANNING

You have five choices with respect to your estate planning and provision for your disabled child:

Disinheritance. You can simply disinherit the child. This is not a good idea even if your child has minimal needs, because most needs are being covered by public benefits. Public benefit programs are being scaled back all across the country and it is possible that some day the public benefits your child is receiving may no longer be available.

Gift to Disabled Child. You can make a gift to your disabled child. The problem is if your child is receiving means-tested public benefits or may receive means-tested public benefits in the future, the gift from you will disqualify your child from receiving those benefits. As you know, these benefits are crucial. The medical benefit may be worth hundreds of thousands or even millions of dollars over your child's lifetime.

Distribute to Siblings. You can make a distribution to a sibling with the understanding they will take care of the disabled child. This is a risky proposition. Assets you leave to your disabled child's sibling are subject to creditors of that sibling. If your healthy child is in an automobile accident and has inadequate insurance, the injured party can recover all of your healthy child's assets, including those you wanted set aside for your disabled child. They may also be claimed in a divorce action and there is a risk of misappropriation or mismanagement by the sibling.

Support Trust. Establishment of a support trust. Many parents working with inexperienced lawyers establish support trusts for the benefit of their disabled children. These trusts are considered "available" for public benefit purposes and

disqualify the disabled child from receiving public benefits.

Special Needs Trust. Establishment of a special needs trust. The solution is to establish a special needs trust for the disabled child. The trust is designed so that the assets are not available for public benefits purposes. By utilizing such a trust the child can retain public benefits and also enjoy the assets left by the parent.

TYPES OF BENEFITS

At your meeting you should talk about the types of public benefits your child may be receiving now or in the future. If your child is receiving or may receive SSI, Medicaid, Section 8 Housing or benefits through the Division of Developmental Disabilities, these benefits are means-tested. If your child is simply receiving SSD and Medicare, these benefits are not means-tested. For means-tested public benefits the rule of thumb is that the recipient may not have more than \$2,000 of assets and receipt of income is also considered. If your child is simply receiving SSD and Medicare, a support trust may be more appropriate than a special needs trust. However, if there is any possibility that the child may be receiving means-tested public benefits in the future, a special needs trust is usually the better choice.

REASONS FOR TRUST

Besides protecting public benefits there are other reasons for establishing a trust for your disabled child. These reasons are usually associated with achieving independence for your child. The benefits in establishing a trust include the following:

- Control of trust assets
- Protection from friends
- Protection from spouses
- Protection from creditors

- Professional money management
- Professional legal advice

FUNDING THE TRUST

When you establish your trust decide how much money will be needed to fund the trust. For many families their first instinct is to divide their assets on death equally among their children. When there is a disabled child, this may not be a good formula. Your healthy children probably are able to work and support themselves. Your disabled child may not be able to work at all or his or her work may be limited. What will happen to that child if public benefits disappear?

The best way to answer this question is to focus on the needs of the disabled child. You have three choices with respect to calculating the amount necessary to ensure that your child will live that lifestyle:

- Life Care Planner. You can hire a life care planner to do a life care plan for your child and calculate the cost of achieving that care. This is by far the most accurate way to make this determination. However, it is also expensive.
- Merrill Lynch Calculator. Merrill Lynch has a calculator on its website, which you can visit and calculate a number which should approximate the cost of meeting your child's future needs.
- Multiplier. A third way to calculate the cost of meeting your child's future needs would be to quantify those needs by completing a budget form and then multiplying by a factor that will determine the amount of money that would need to be invested to produce an annual income sufficient to meet your child's needs. For example, if you believe that your investments will produce a 5% rate of

return, you would use a factor of 20. You divide the number 100 by 5% to get the 20. If you believe that you could get a 3% rate of return, the number would be 33.

Once you have calculated the amount you will need to determine where you will get the money to put into the trust. Most parents would like to leave their healthy children something, so begin by setting aside an amount for them. Then compare the amount you have left over with the amount you feel you will need for your child. In many instances, there will be a significant shortfall. Consider purchasing life insurance to make up that shortfall. Try to avoid buying term insurance, because your child's need will not go away. Over time, the cost of term insurance will increase significantly. You are usually better off buying a smaller amount of whole life insurance.

SELECTION OF TRUSTEE

Parents. Generally, parents will serve as trustee of a special needs trust as long as either parent is alive. The problem arises when the parents die.

Family Members. The most common option for selection of a trustee is a family member. There are two reasons why family members are preferred. There is a perception that the family member will not charge a fee and a belief that the family member has the best interest of the disabled child at heart. Neither of these assumptions are necessarily valid. Fees charged by professional trustees are modest, usually about 1% of trust assets per year. Because of professional expertise, they are usually able to invest the money to more than offset the 1% charge. Appointing siblings of the disabled person as trustee puts them in a bad position. One of the trustee's jobs is to say "no" to the disabled person if they make unreasonable requests for trust distributions. This builds resentment between the disabled child and the sibling trustee.

Professional Trustee. Professional trustees include banks, attorneys, CPAs and other professionals.

Financial advisors are usually prohibited from serving as trustee if they are going to manage the money. The advantages in selecting a professional trustee are that they are able to provide expert money management and they are familiar with public benefit laws.

Siblings can serve on a Trust Advisory Committee and look after the interest of your disabled child.

Non-profit Organizations. Certain non-profit organizations are willing to serve as trustees. They often have expertise in dealing with persons with disabilities and know public benefit laws. They also can provide professional money management.

Co-Trustees. Another solution is usually to have a family member and a professional serve as co-trustees. The professional brings the expertise in money management and public benefits laws. The family member is in a better position to know your disabled person and his or her needs.

DUTIES OF TRUSTEE

In selecting a trustee it is important to understand the trustee's duties. The trustee is a fiduciary, which means that he or she must act in the best interest of the beneficiary of the trust. The trustee is held to a high standard of performance. Trustees must invest the trust assets in accordance with the Prudent Investor Act or the Prudent Man Rule, depending on state law. They must furnish accountings in accordance with the Principal and Income Act. They must carry out the terms of the trust agreement, and they must be loyal to the beneficiary.

The trustee should set an agenda for distributions to the beneficiary. If the trustee distributes cash directly to the beneficiary, it is likely that this will adversely affect the beneficiary's public benefits. It may even cause these benefits to be lost. If the trustee distributes money to third party providers of goods and services, as a general rule, this has no

effect on the beneficiary's public benefits. This is the best way to make distributions.

But if a trustee makes distributions to a third party for food and shelter for the beneficiary, this is called in-kind support and maintenance or ISM. These distributions cause a reduction in the SSI benefit of approximately one-third, but do not affect most other benefit programs.

There are certain distributions for goods which are permitted that usually have no effect on public benefits eligibility. These are as follows:

- Purchase a home;
- Household goods of reasonable value;
- Weatherization assistance, such as insulation, storm doors and windows;
- Tools to perform home improvements, repairs and maintenance by homeowner;
- Furniture;
- Handicap van or regular car;
- Durable medical equipment, such as wheelchairs;
- Television, radio and cable service;
- Audio/video equipment;
- Stereo system;
- Telephone, answering machine;
- Recreational equipment, games and crafts; and
- Musical instruments.

In addition, there are certain distributions for services that have no effect on public benefits eligibility. These are as follows:

- Home improvements, repairs, and maintenance by outside source;
- Travel and education;
- Recreation and entertainment;
- Medical insurance;
- Telephone bills;
- Newspaper subscriptions;
- Services of a care manager;
- Vacations;
- Travel expenses of relatives;
- Movies;

- Tax payments;
- Medical treatment for which public funds are unavailable;
- Difference between a private and semi-private room in an institution;
- Installation of a burglar alarm or monitoring/response system in home;
- School tuition, books and supplies;
- Health and Life insurance premiums;
- Cleaning supplies and paper products;
- Dental care, physical therapy, massages, support services, and other medical costs not covered by any benefit programs;
- Home care services not covered by another program;
- Personal services, including lawn mowing, house cleaning, grocery shopping and babysitting;
- Airline and other transportation tickets - used for travel by a beneficiary or spouse or parent whose income is subject to deeming is not countable income to the beneficiary if used for travel among the 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, America Samoa and Northern Mariana Islands. The ticket is not considered income unless it is converted to cash; and
- Non-domestic travel - a ticket for non-domestic travel must be non-refundable.

REPORTING GUIDELINES

If the beneficiary is receiving SSI, then the reporting requirements of the Social Security Administration must be satisfied. Once the trust is funded, the trust should be sent to Social Security for approval. The following events must be reported to Social Security:

- Address. Change in Beneficiary's address.
- Employment. Change in employment status.
- Living Arrangements. Change in the arrangements (such as adding or losing a roommate).

- Income. All income (including the receipt of any direct income or ISM from the Trust)
- Resources. Any change in countable resources.
- Medical Insurance Coverage. Any change in the Beneficiary's medical insurance coverage.
- Marital Status. Any change in the Beneficiary's marital status.
- Physical or Medical Condition. Changes or improvements in Beneficiary's physical or mental condition (for example, the Beneficiary improves so much that he or she is no longer considered disabled).
- Medical Facility. Admission to or discharge from any health facility or public facility (such as a hospital or nursing home).
- Travel. Any trip outside the United States.
- Other Public Benefits. New eligibility for other public benefits.

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As you can see, the establishment and administration of a special needs trust is complex. However, it is critical for your disabled child's future.

ABOUT THIS DOCUMENT

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