

A Pennsylvania Guide to Special Needs Trusts¹

By Jeffrey A. Marshall, CELA²

A. Overview of Medicaid Implications of Trusts

Public benefit programs like Medicaid and SSI³ can provide substantial support for disabled individuals. But these are needs-based programs which limit benefits to persons who meet the programs' financial standards. Several forms of trust are widely used to preserve a beneficiary's eligibility for these government programs while avoiding spend down of assets that might be utilized to enhance the quality of the beneficiary's life or achieve other planning goals. While this chapter's focus is Medicaid, a lawyer involved in drafting or administering the trust must be aware of the trust's impact on many other public programs that may be available to a disabled beneficiary.⁴

Medicaid defines a trust as an arrangement in which a grantor transfers property to a trustee with the intention that it be held, managed, or administered by the trustee for the benefit of the grantor or others. The definition includes any legal instrument or device that is similar to a trust.⁵

Trusts can raise complex Medicaid issues. Some trusts may be deemed to contain available resources which disqualify a beneficiary from Medicaid, while other trusts may be deemed to be unavailable and thus non-disqualifying. One common form of trust is structured so

¹ Copyright 2009 by Jeffrey A. Marshall. This material may be printed out for personal use but may not be disseminated without the written approval of the author.

² Attorney Marshall is the Managing Attorney of the law firm of Marshall, Parker & Associates which has offices in Williamsport, Wilkes-Barre, Scranton, and Jersey Shore, Pennsylvania. Telephone 1-800-401-4552; website: www.paelderlaw.com. Mr. Marshall is a CELA - Certified as an Elder Law Attorney by the National Elder Law Foundation. This material is current as of January 2009.

³ Many older and disabled persons also receive income from the Supplementary Security Income (SSI) program. Supplemental Security Income (SSI) is a federal income supplement program that assists low income aged, blind, and disabled individuals by providing cash to meet basic needs for food, clothing, and shelter with related Medicaid coverage providing for health care. Although Medicaid eligibility rules for aged and disabled persons often follow SSI income and asset rules, they sometimes differ. If SSI eligibility is an issue, the practitioner should consult the SSI regulations (20 C.F.R. § 416 et seq.) and the Social Security Program Operations Manual (POMS), which is available online at <https://secure.ssa.gov/apps10/poms.nsf/chapterlist!openview&restrictcategory=05>. SSI provisions regarding trusts are found in POMS Section SI 01120.200, <https://secure.ssa.gov/apps10/poms.nsf/lnx/0501120200!opendocument#g>.

⁴ Such programs include Veterans benefits, housing assistance, pharmaceutical programs and income support. See Begley, "Utilizing Public Benefits in Special Needs Planning," a chapter from the *11th Annual Elder Law Institute*, Pennsylvania Bar Institute Pub. No.2008-4093, published July 2008. See also, "Estate Planning for Families of Persons with Disabilities Lawyer's Edition," Disability Rights Network of Pennsylvania (February 2007), <http://www.drnpa.org/File/publications/estate-planning-for-families-of-persons-with-disabilities-lawyer--s-edition.pdf>

⁵ 42 U.S.C. § 1396p(d)(6); 55 Pa.Code §178.2.

that income is deemed to be available while principal is not.⁶ The funding of some forms of trust may be treated as a transfer of assets resulting in the imposition of a transfer penalty. Trusts also vary in regard to the extent to which they are subject to eventual reimbursement claims by the state Medicaid agency.

Medicaid's underlying trust provisions were enacted in 1993.⁷⁸ These rules apply only to trusts created by an individual or his or her spouse, other than by Will, if assets of the individual were used to form any part of the trust corpus.⁹ An individual is also considered to have established a trust if it was established by a person, including a court or administrative body, with legal authority to act in place of or on behalf or acting at the direction or upon the request of the individual or the individual's spouse.¹⁰ When the corpus of the trust includes the assets of an individual and the assets of other persons, the Medicaid rules apply only to that portion of the trust attributable to the assets of the individual.¹¹

The rules treat the principal of a trust as available when determining eligibility if there is any circumstance under which it may become payable to the Medicaid applicant, regardless of whether the trustee has discretionary powers. Similar treatment is applied to the trust income.

Revocable trusts are governed by 42 U.S.C. §1396p(d)(3)(A).¹² The corpus of a revocable trust is a fully available resource and payments from the trust to or for the benefit of the Medicaid applicant/recipient are treated as available income. Payments from the trust to others are treated as assets disposed of by the individual for less than fair market value, and are subject to Medicaid's transfer penalty provisions.

In the case of irrevocable trusts, 42 U.S.C. §1396p(d)(3)(B) provides:

(i) if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual, and payments from that portion of the corpus or income—

(I) to or for the benefit of the individual, shall be considered income of the

⁶ The irrevocable income only trust (IIOT). See discussion of irrevocable grantor trusts below.

⁷ 42 U.S.C. §1396p(d) enacted under the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), Pub. L. 103-66, Title XIII §13611(d)(1)(C), 107 Stat. 627 (1993).

⁸ Different rules govern the treatment of pre-OBRA trusts created before July 30, 1994. 55 Pa.Code §178.4(c), 178.7.

⁹ 42 U.S.C. §1396p(d)(2)(A); 55 Pa.Code § 178.7(b).

¹⁰ 42 U.S.C. §1396p(d)(2)(A).

¹¹ 55 Pa.Code § 178.7(b).

¹² See also, 55 Pa.Code §178.7(e)(1).

individual, and

(II) for any other purpose, shall be considered a transfer of assets by the individual; and

(ii) any portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual for purposes of the transfer penalty rules], and the value of the trust shall be determined [for purposes of calculating the transfer penalty] by including the amount of any payments made from such portion of the trust after such date.¹³

Despite these restrictions, trusts are a valuable and often utilized tool for enhancing the support and protection of assets for a beneficiary who needs, or may someday need, Medicaid benefits. Two general categories of trust are used to enhance Medicaid eligibility: (1) Special Needs Trusts, whose funding is exempt from Medicaid transfer rules,¹⁴ and (2) Irrevocable Grantor Trusts which are subject to Medicaid transfer penalties.

B. Special Needs Trusts

The term “special needs trust” is generally used to refer to a trust whose funds are deemed to be “unavailable” for purposes of means tested public benefit programs like SSI and Medicaid.¹⁵ It is designed to complement rather than replace public benefit supports that are available to the beneficiary. Thus it is supplemental trust rather than a support trust. There are three basic varieties of special needs trust commonly used in Pennsylvania:

- (1) Common law trusts, also sometimes referred to as “3rd party trusts” and “discretionary special needs trusts” are created by someone other than the public benefit beneficiary. Since these trusts were not created by the individual the harsh Medicaid trust provisions of 42 U.S.C. §1396p(d)(3) do not apply. This type of trust is frequently a testamentary trust created by the testator for a disabled beneficiary of the estate.

¹³ 42 U.S.C. §1396p(d)(3)(B); 55 Pa.Code §178.7(e)(2).

¹⁴ The exclusion from transfer penalty applies only if the disabled settlor is under age 65. The Centers for Medicare and Medicaid Services (CMS) has stated that the mandatory nature of the penalty that must be imposed upon persons over age-65 when they transfer assets into a pooled trust (CMS State Agency Regional Bulletin, No. 2008-05). (Unlike pay-back trust federal Medicaid law does not restrict creation of a pooled trust accounts to individual who are under age 65. But see, discussion of Pennsylvania law under section 1414 of Act 42 of 2005 below.)

¹⁵ A Pennsylvania statute uses a more limited definition of “special needs trust” to refer to “a trust or an account in a pooled trust that is established in compliance with this section for a beneficiary who is an individual who is disabled, as such term is defined in Title XVI of the Social Security Act (42 U.S.C. § 1382c(a)(3)), as amended, consists of assets of the individual and is established for the purpose or with the effect of establishing or maintaining the beneficiary’s resource eligibility for medical assistance.” 62 P.S. § 1414(f) (Act 42 of 2005, section 1414).

- (2) Self-Funded Special Needs Trusts (also known as “(d)(4)(A) trusts,” “payback trusts” and “under 65 trusts”) are created under 42 U.S.C. §1396p(d)(4)(A). These trusts are created from the funds of the disabled beneficiary and require payback to the state for Medical Assistance benefits.
- (3) Self-Funded Pooled Trusts (also known as “(d)(4)(C) trusts” are created under 42 U.S.C. §1396p(d)(4)(C) from the funds of the disabled beneficiary but must be managed by a non-profit fiduciary as trustee. At the death of the disabled beneficiary, the residue of funds remains in Trust for other disabled persons. Under 62 P.S. §1414(b)(3)(iii) Pennsylvania requires that a portion of the residue be available for payback to the state, but the validity of the payback provision is questionable as discussed below.

Practical Tip: Do NOT include a payback provision in a common law special needs trust. It is not required. Name contingent beneficiaries instead.

C. Common Law Special Needs Trusts

Common law special needs trusts enable families to make financial contributions for the benefit of a person who requires or may someday require public benefits without affecting the beneficiary’s entitlement to the government benefits. They can be created *inter-vivos* by a third party other than the spouse of the beneficiary,¹⁶ or as testamentary trusts by any third party including a spouse.¹⁷

Practical Tip: Planning with Special Needs Trusts should not be limited to the parents of a special needs child. Grandparents and other relatives should consider the advantages of leaving potential inheritances for those needing government benefits to a common law special-needs trust, rather than to the person with disabilities directly, in order to preserve eligibility for government programs. Beneficiary designations on retirement accounts and life-insurance policies should also be reviewed and updated.

Whether a trust created by someone other than the Medicaid applicant/recipient and spouse will be considered to be an available resource depends on whether the trust is accessible to the applicant for support and maintenance. In Pennsylvania, a series of appellate decisions spanning the past quarter century has provided examples of various issues that determine whether a trust will be considered an available resource for a person seeking Medicaid benefits. Traditional fiduciary principles are applied to determine the scope of the trustee’s duty to the beneficiary. If the beneficiary has a right of support that was enforceable against the trustee, the court has found the trust, or the relevant portion,

¹⁶ An inter-vivos trust created by a Medicaid applicant’s spouse is deemed to have been created by the Medicaid applicant. 42 U.S.C. §1396p(d)(2)(A); 55 Pa.Code § 178.7(b).

¹⁷ A testamentary special needs trust created by a predeceasing spouse may raise elective share issues.

to be an available resource for Medicaid purposes. Where support is not mandated but other discretionary standards are imposed, the courts have looked for the intent of the testator in determining whether the trust was designed to supplement or supplant public benefits.

In *Stoudt v. DPW*, 464 A.2d 665 (Pa.Cmwlt. 1983), the trustee had discretion to “pay so much of income and principal as he in his sole discretion deems necessary for the maintenance and support” of the beneficiary under her father’s will. The Commonwealth Court held that because the trustee had a duty to administer the trust solely in the interest of the beneficiary, and the beneficiary had the right to compel the trustee to make distributions for her support, the entire corpus was an available resource that disqualified the beneficiary from public benefits.

A different result obtained in *Lang v. DPW*, 528 A.2d 1335 (Pa. 1987). A discretionary support trust was created for the life of a mentally disabled child. Income could be sprinkled to the disabled child in the trustee’s discretion or could be accumulated and added to principal, or, if not necessary for the support of the child, could be distributed to the other children of the testator. In addition, principal could be used for the “maintenance, welfare, comfort and support” of the beneficiary. The remainder was distributable to the other children of the testator. There, the Supreme Court held that since there was no duty imposed on the trustee to use the trust for the exclusive benefit of the disabled beneficiary and no intent was found in the will to create such a duty, the trust was not an available resource.

In *Snyder v. DPW*, 598 A.2d 1283 (Pa. 1991), a testamentary sprinkle trust was created, consisting of the “bulk” of the estate for the benefit of two adult disabled children during their lives, with the remainder to the other children of the testator. The trust provided for payment of income “as may be necessary or desirable for the support, maintenance and care” of the disabled beneficiaries; in addition, the trustee could use principal for the support, maintenance, and care of the beneficiaries in the trustee’s discretion. There, the Supreme Court held that the income was available but the principal was not available, due to the existence of multiple beneficiaries and the receipt by one of the disabled beneficiaries of public benefits prior to the death of the testator.

In *Commonwealth Bank & Trust v. DPW*, 563 A.2d 1299 (Pa.Cmwlt. 1989), a \$25,000 trust was created under will for the sole benefit of the testator’s mother for life, with income payable in the trustee’s discretion, considering other income and principal resources available, with principal to be distributed as the trustee deems “needful or desirable for her support and maintenance, including medical, surgical, hospital or other institutional care.” The Commonwealth Court held that the trust was an available resource to pay the mother’s nursing home expenses.

In *Rosenberg v. DPW*, 679 A.2d 767 (Pa. 1996), a typical residuary credit-shelter trust was created for the testator’s widow, which provided that the trustee pay the net income to the beneficiary, and was authorized, in his “sole discretion, to use principal for the comfort, welfare, and maintenance and support, for educational requirements, medical and surgical

expenses, and other unusual needs” of the widow, and the remainder was distributable to the testator’s issue, per stirpes. On appeal to the Supreme Court, it was held that the trust was an available re-source to pay the widow’s nursing home expenses.

The foregoing cases have clarified how to analyze the availability of trusts created by third parties for the support of a beneficiary on public benefits, and provide guidance for creation of supplemental needs trusts that will preserve present or future eligibility for beneficiaries who would otherwise qualify for public benefits. The cases demonstrate how the courts struggled to weigh various terms and family circumstances in order to glean the intent of the settlor or testator, since there was no clear expression of intention.

Practical Tip: Make certain that the trust unambiguously expresses the intent of the settlor or testator that the trust principal and income are to be used to supplement, not supplant, public benefits. The trustees should have absolute discretion over the payment of income or principal to the disabled beneficiary. The trust should include contingent beneficiaries and express the settlor/testator’s intent to ultimately benefit the remaindermen.¹⁸

D. Special Needs Exception Trusts

When Congress enacted the Medicaid trust rules in 42 U.S.C. §1396p(d) of the Medicaid Act in 1993, it created several exceptions from normal trust treatment for certain trusts established by disabled individuals. And it exempted the funding of these disability trusts from the Medicaid transfer penalty provisions. These exceptions established the statutory basis for what CMS refers to as “exception trusts.” Exception trusts are 1st party trust used to protect assets owned by the individual in need of public benefits.

The exceptions are set out in 42 U.S.C. §1396p(d)(4).¹⁹ The two notable types of exception trust in use in Pennsylvania are:

- (1) §1396p(d)(4)(A) Trust - which is a trust containing the assets of an individual under age 65 who is disabled and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual.

¹⁸ See Dennis C. McAndrews “Special Needs Trusts: Critical Uses & the Developing State of the Art,” a chapter from the *8th Annual Estate and Elder Law Symposium*, Pennsylvania Bar Institute Pub. No.4556, published February 2007.

¹⁹ Similar statutory provisions were incorporated into the SSI Program in 1999 at 42 U.S.C. §1382b(e)(5). See, the Foster Care Independence Act of 1999, which added trust and transfer provisions to the SSI law. Section 205 adds subsection (e) to 42 USC 1382b and applies to trusts created on or after January 1, 2000. For regulations, see Social Security POMS Section SI 01120.203, <https://secure.ssa.gov/apps10/poms.nsf/lrx/0501120203>.

- (2) §1396p(d)(4)(C) Trust - which is a pooled trust containing the assets of individuals who are disabled. The pooled trust must be established and managed by a non-profit association, must maintain a separate account for each beneficiary of the trust, (but, for purposes of investment and management of funds, the trust pools these accounts), and to the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary.

E. More on Special Needs Exception Trusts - (d)(4)(A) (Pay-Back) Trusts

No transfer penalty is applied to the funding of a trust containing the assets of a disabled individual under age 65 if the trust is established for the benefit of the individual by a parent, grandparent, legal guardian of the individual, or a court, and the trust contains a provision that the Commonwealth will receive the amounts remaining in the trust upon the death of the individual, up to the amount of the Medicaid benefits paid on behalf of the individual.²⁰ Although the trust must be settled by a parent, grandparent, legal guardian, or court, the assets used to fund the trust are those belonging to the beneficiary, which often consist of the proceeds of a personal injury action or an inheritance. The literal language of the statute does not allow a competent disabled person to be the settlor of his or her own trust.

The individual must be under the age of 65 at the time the trust is established and funded. Assets cannot be added after the individual reaches age 65 although the trust's exception status continues as to assets funded prior to that age.

Pay-back trusts are frequently utilized to hold the proceeds of personal injury settlements to allow the plaintiff to continue to receive Medicaid benefits. The Pennsylvania Rules of Civil Procedure explicitly permit the use of special needs trusts in resolving civil litigation.²¹

F. More on Special Needs Exception Trusts – Pooled Trusts²²

A pooled trust must be established and administered by a non-profit organization. "It is sometimes called a "master trust" because it contains the assets of many different individuals, each in separate accounts established by individuals, and each with a beneficiary. By analogy, the pooled trust is like a bank that holds the assets of individual account holders. Whenever you are evaluating the trust, it is important to distinguish between the Master Trust, which is established by the non-profit association, and the

²⁰ 42 U.S.C. § 1396p(d)(4)(A).

²¹ See Rules 2039, 2064, and 2206 of the Pennsylvania Rules of Civil Procedure.

²² 42 U.S.C. §1396p(d)(4)(C). See regulations at 55 Pa Code § 178.7(f)(2); see also, Act 42 § 1414 (2005) discussed below.

individual trust accounts within The Master Trust, which are established by the individual or another person for the individual.”²³

The beneficiary joining a pooled trust must be an individual under the age of 65, with a disability as defined by 42 U.S.C. § 1382c (a) (3). The Trust must be established and maintained by a nonprofit association with an individual account for each beneficiary. The pooled trust account has a number of advantages over the (d)(4)(A) pay-back trust, including the ability to receive relatively small fund values, potentially lower fees, broader investment options, and relatively easy and quick establishment. However, the residue of funds contributed cannot be directed to other family members on the death of disabled individual.²⁴

A pooled trust typically operates under a master trust agreement. To participate in the trust, the settlor signs a trust joinder agreement.²⁵ There are several pooled trusts operating in Pennsylvania, including:

The ARC Community Trust of Pennsylvania, 1004 West 9th Ave., King of Prussia, PA 19406, Phone: 610-265-4788, www.arcommunitytrustpa.org;

Berks Community Trust, c/o the Arc of Berks County, 1829 New Holland Road, Reading, PA 19607, 610-603-0227, www.berksiu.org/arc/trust/htm.

The Achieva Family Trust, 412-995-5000, <http://www.achieva.info/trustservices.php>.
Family Trust President, Kathleen D. Hendrickson, via email at khendrickson@achieva.info

G. State Imposed Restrictions on Special Needs Exception Trusts

In Act 42 of 2005, Pennsylvania enacted some question-able limitations on the use of pay-back trusts and pooled trusts. Section 1414 of Act imposes restrictions based on (1) the disabled individual's age; (2) the characteristics of the individual's needs in relation to disability; (3) what expenditures trusts can make to improve the disabled individual's quality of life under the trust instruments; and (4) what percentage of any funds remaining in their trust accounts after their deaths can be retained by the trust to assist other disabled individuals.

Section 1414(b) reads as follows:

²³ U.S. Soc. Sec. Admin., Program Operations Manual Sys., POMS S.I. 01120.203B.2(a).

²⁴ See “Special Needs Trusts” Pennsylvania Bar Institute Pub. No.4637, published December 2006, at 126.

²⁵ Examples of the form of agreements used by The Family Trust pooled trust are available online at the <http://www.achieva.info/pooled>.

(b) A special needs trust shall comply with all of the following:

(1) The beneficiary shall be an individual under the age of sixty-five who is disabled, as that term is defined in Title XVI of the Social Security Act (49 Stat. 620, 42 U.S.C. § 1381 et seq).

(2) The beneficiary shall have special needs that will not be met without the trust.

(3) The trust shall provide:

(i) That all distributions from the trust must be for the sole benefit of the beneficiary.

(ii) That any expenditure from the trust must have a reasonable relationship to the needs of the beneficiary.

(iii) That upon the death of the beneficiary, or upon the earlier termination of the trust, the department and any other state that provided medical assistance to the beneficiary must be reimbursed from the funds remaining in the trust up to an amount equal to the total medical assistance paid on behalf of the beneficiary before any other claimant is paid: Provided, however, That in the case of an account in a pooled trust, the trust shall provide that no more than fifty percent of the amount remaining in the beneficiary's pooled trust account may be retained by the trust without any obligation to reimburse the department.

(4) The department, upon review of the trust, must determine that the trust conforms to the requirements of Title XIX of the Social Security Act (42 U.S.C. § 1396 et seq.), this section, any other State law and any regulations or statements of policy adopted by the department to implement this section.²⁶

In *Lewis v. Richman*,²⁷ two Pennsylvania pooled trusts and related plaintiffs are seeking to enjoin the provisions of Section 1414 that restrict Medicaid eligibility and require a minimum 50% state reimbursement from pooled trusts. During the pendency of this litigation DPW agreed that it would not deny MA eligibility to an individual on whose behalf an account had been established with The Family Trust, solely because The Family

²⁶ Section 9 of Act 42 of 2005, 62 P.S. §1414, was apparently enacted in part to overturn the decision of the Allegheny County Court of Common Pleas in *Lewis v. Magee Women's Hospital*, 67 Pa. D. & C. 4th 362 (Pa. Com. Pl. 2004).

²⁷ In *Lewis v. Richman*, (U.S. District Court Eastern District of PA NO. 06-3963) Plaintiffs seek to enjoin DPW's enforcement of Section 9 of Act 42 of 2005 (62 P.S. § 1414) as inconsistent with the Medicaid Act, Title XIX of the Social Security Act, 42 U.S.C. §§1396 et seq., and violative of the Supremacy Clause of the United States' Constitution. On the basis that Section 1414 impermissibly restricts the Medicaid eligibility of certain disabled individuals and permits the seizure of funds by the state that are intended to benefit disabled individuals.

Trust Master Trust Agreement does not incorporate the provisions of Section 1414.²⁸

²⁸ *Lewis v. Richman*, (U.S. District Court Eastern District of PA NO. 06-3963) Stipulations ¶ 55 & Exhibit “K”.