

NEW JERSEY LAWYER

A matter of trust: Protecting the disabled

By Regina M. Spielberg

The Smiths have four children and assets totaling approximately \$3,000,000. Their typical estate plan might provide for disclaimer trust wills, with the estate of the surviving spouse passing outright to their descendants or held in a separate trust for any descendant who was under a certain age with discretionary distributions permitted for the health, maintenance, support and education of the beneficiary.

One of the Smiths' children, however, is disabled. The "typical" estate planning strategy could disqualify the disabled beneficiary from important government benefits.

In order to develop the appropriate plan for the Smiths, the practitioner needs to understand their intentions for their disabled child and what that child's future financial requirements will be in light of his disability. If the Smiths' intend their disabled child to qualify for government benefits, the estate plan must integrate government benefits planning or risk costing the disabled beneficiary tens of thousands of dollars in lost benefits.

Furthermore, the family may miss the opportunity to provide him with the means to pay for basic supplemental needs such as transportation, special programs and attendant care.

Government benefit programs

When evaluating the effect of a potential inheritance on a disabled beneficiary, the attorney should be aware of the government benefits programs the beneficiary presently receives or may be entitled to in the future. Factors to consider in preserving government benefits are the availability of assets and income to the disabled beneficiary, reimbursement of benefits upon the beneficiary's death through estate recovery or payback provisions and the transfer of assets rule.

The primary government programs for disabled persons are Supplemental Security Income (SSI), Medicaid, Social Security Disability and Medicare. Of these programs, only SSI and Medicaid are means-tested.

SSI is administered by the Social Security Administration and provides cash assistance for the elderly, disabled and blind.

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SSI recipients are limited to \$2,000 in countable resources. The maximum SSI monthly income is currently \$603 per month. The regulations governing SSI are found at 20 C.F.R. 416.101, *et seq.* The Program Operations Manual System (POMS) of the Social Security Administration also governs the program. New Jersey SSI beneficiaries automatically qualify for Medicaid. Both SSI and Medicaid penalize the transfer of assets for less than fair market value.

Medicaid is a welfare program administered by the state under the supervision of the Centers for Medicare and Medicaid. Financial eligibility for Medicaid is based upon income and resources. Generally, Medicaid beneficiaries may have countable resources of no more than \$2,000. Medicaid governing laws are found at 42 U.S.C. §1396, *et seq.*, N.J.S.A. §30:4D-1, *et seq.* and N.J.A.C. §10:49-1.1, *et seq.* Federal and New Jersey laws provide for the recovery of nursing home and long-term care Medicaid expenses from the estate of a Medicaid beneficiary. New Jersey regulations define the estate to include probate and nonprobate assets. N.J.A.C. §10:49-14.1(1). A life estate interest which ends on the death of the Medicaid beneficiary is not subject to estate recovery. Trusts established by a third party for the benefit of a Medicaid beneficiary are also not subject to estate recovery if the trust contains no assets owned by the Medicaid beneficiary within five years.

Trusts for a disabled beneficiary

Estate planning offers unique challenges when a beneficiary is disabled. The Smiths are greatly concerned about what will happen to their disabled child when they are no longer able to care for him. It is their intention their son qualify for any government benefits available to him. An outright distribution of the disabled child's share under Mr. and Mrs. Smith's wills would likely cause the disabled beneficiary to exceed resources limits and result in disqualification for means-tested benefits. Similarly, if an estate plan utilizes a testamentary or *inter vivos* trust that provides for discretionary distributions for health, maintenance, support and education to or for the benefit of the disabled beneficiary, the trust assets will be deemed an available resource jeopardizing government benefits eligibility. A trust providing distributions will be reduced if the beneficiary may be eligible for Medicaid benefits will be deemed null and void. N.J.S.A. §30:4D-6(f).

Crummeys

The use of Crummey powers to qualify a gift to an *inter vivos* trust for the annual gift tax exclusion may also be problematic. The portion of the gift over which a disabled beneficiary has a right of withdrawal will be treated as income in the month it is received by the trust and as a countable resource thereafter until the power lapses. Failure to exercise the power will be treated as a transfer of assets by the disabled beneficiary.



Disinheritance

Disinheriting the disabled person, on the assumption siblings will provide for him or her, can be disastrous if the siblings have creditor or divorce issues or if the siblings do not use the funds for the disabled person.

Supplemental benefits trust

A better choice would be to create a supplemental benefits trust for the disabled child. This type of trust, whether *inter vivos* or testamentary, is intended to supplement, not supplant, available government benefits. A supplemental benefits trust is funded with assets owned by someone other than the disabled beneficiary. The trust gives the trustee discretion to provide for the beneficiary's "special needs" — goods and services not provided by public or charitable programs. On the disabled beneficiary's death, the trust may provide for distribution to other family members. If the disabled beneficiary does not have the legal authority to revoke the trust or direct the use of the trust assets for his or her own support and maintenance, the trust principal is not counted as an available resource. POMS §SI 01120.200. The purpose of the trust and the intent of the testator, or in the case of an *inter vivos* trust the grantor, should be detailed to prevent it from later being determined to be a support trust.

Protecting a disabled spouse or domestic partner

Traditional estate planning techniques also pose a dilemma for a surviving spouse or domestic partner requiring long-term care.

If a decedent's estate passes to a disabled spouse, either outright or to a trust providing for discretionary principal distributions for health, maintenance and support, the surviving disabled spouse will be ineligible for Medicaid due to excess resources. Any portion disclaimed by the surviving spouse or domestic partner will be deemed a transfer of assets and create a penalty period of Medicaid ineligibility.

The New Jersey elective share statute provides the surviving spouse or domestic partner with a right of election to take a one-third share of the augmented estate under the limitations and conditions of N.J.S.A. §3B:8-1, *et seq.* If the surviving spouse or domestic partner is omitted from the will or receives less than the value of the elective share and does not exercise his or her right of election, Medicaid will deem the surviving spouse or domestic partner to have made a transfer of assets in the amount not so elected. If the surviving spouse or domestic partner is incapacitated, he or she may not be able to exercise the right of election. If there is a court-appointed guardian of the property, the right of election may only be exercised by court order upon a finding the elective share is necessary to provide adequate support for the surviving spouse or domestic partner during his or her probable life expectancy. N.J.S.A. §3B:8-11.

The elective share may be satisfied by a trust providing a life estate interest to the surviving spouse. The trust is then valued at one-half of its total value. N.J.S.A. §3B:8-17. A properly drafted testamentary supplemental benefits trust, benefiting the surviving spouse or domestic partner, funded with the equivalent of the elective share and providing for income payments to the beneficiary, will not trigger the transfer of assets rule as the elective share will be satisfied. The assets of the trust will not be considered countable resources so the surviving spouse or domestic partner may qualify for Medicaid benefits. As previously discussed, trust distributions from the elective share supplemental benefits trust may be made in the trustee's sole discretion to supplement those needs of the surviving spouse or domestic partner that are not met by public or charitable benefits.

Medicaid's right of recovery may apply to assets held in an elective share trust for the benefit of the spouse or domestic partner to the extent trust assets were transferred to the decedent (i.e. community spouse or domestic

partner) from the Medicaid recipient spouse or domestic partner within five years. See *Estate of Michael DeMartino v. State of New Jersey, Division of Medical Assistance and Health Services* 373 N.J. Super. 210 (App. Div. 2004). In *DeMartino*, a supplemental benefits elective share trust was created under the will of a community spouse. The state successfully recovered the value of the benefits paid by Medicaid for the surviving institutionalized spouse from the remaining trust assets, although the terms of the trust prohibited the funds to be used in such a manner. The court permitted recovery because the trust was funded with assets transferred to the decedent by the surviving institutionalized spouse within five years.

Fixing a problem inheritance

Family members should be aware of the impact a gift or inheritance can have on a disabled beneficiary's government benefits eligibility. Problems arise, however, when relatives, particularly grandparents, make well-intentioned arrangements for a disabled person that jeopardize such benefits.

Reforming a will for the purpose of effectuating eligibility for government benefits may be possible if the probable intent of the testator was to provide for the supplemental care of the disabled beneficiary. *Fidelity Union Trust Co. v. Robert*, 36 N.J. 561 (1962) and *Matter of Estate of Branigan*, 129 N.J. 324 (1992). The New Jersey legislature and New Jersey Supreme Court have confirmed that courts are authorized to engage in and to approve government benefits planning. N.J.S.A. §3B:12-49 and *In re Keri*, 181 N.J. 50 (2004).

Special needs trusts

If reformation is not possible, the disabled person may be able to fund a trust that will preserve government benefits in the event an inheritance jeopardizes eligibility. Both Federal and New Jersey law provide for safe harbor trusts, commonly known as special needs trusts that are exempt from the Medicaid and SSI trust rules. If a trust funded with the assets of a disabled individual under age 65 is established for the benefit of that individual by a parent, grandparent, legal guardian, or a court and the state will be repaid upon the death of the disabled individual for the medical assistance paid on behalf of the disabled individual, creating the trust will not trigger the transfer of assets rule and the trust will not be counted as available. 42 U.S.C. §1396p(d), Section 205 of the Foster Care Independence Act of 1999 (amending 42 U.S.C. §1382b) and N.J.S.A. §3B:11-36. If the disabled person does not have a parent, grandparent or legal guardian, a court may establish the trust. N.J.S.A. §3B:11-37(b).

The obvious disadvantage of a special needs trust as compared to a supplemental benefits trust is the special needs trust must provide the state be repaid on the death of the disabled beneficiary.

Additional considerations

In addition to the fiduciary responsibilities all trustees have in administration of a trust, the trustee of a supplemental benefits trust or special needs trust must take care distributions are properly made in light of the asset rules governing the beneficiary's benefits programs. If the trust is not properly administered, the beneficiary may be disqualified from benefits even though the trust is properly drafted.

The estate planning attorney must be aware of how creating an *inter vivos* supplemental benefits trust can impact the grantor's own ability to access government benefits. If, for example, a grandparent wishes to establish a trust for the benefit of a disabled grandchild, funding the trust may be deemed a transfer of assets by the grandparent, who will be penalized in the event he or she applies for Medicaid benefits.

Achieving a client's goal of providing for a disabled beneficiary requires the practitioner combine traditional estate planning techniques with knowledge of sophisticated government benefits planning.