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Trusts for the Benefit of Disabled Persons

Understanding the Differences Between Special Needs Trusts and Supplemental Benefits Trusts

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“Who will care for my loved one when I’m gone?” This is a question regularly faced by concerned families who recognize their resources may be inadequate to provide quality care for their disabled loved ones. Public benefits programs may provide basic necessities for a disabled person, but many programs, such as Medicaid and Supplemental Security Income (SSI), are means-tested and impose financial limitations for eligibility.

A properly drafted special needs or supplemental benefits trust can benefit the disabled person without jeopardizing eligibility for public benefits. Trust assets are made available to provide for the disabled beneficiary’s special needs and to supplement public benefits, often resulting in a greatly improved quality of life.

It is important to distinguish between the two types of trusts most commonly used for disabled beneficiaries, namely the special needs trust and the supplemental benefits trust. The distinction results from whether the assets funding the trust belong to the disabled person or a third party.

This article refers to a trust established and funded with the assets of a third party—usually a family member—either by testamentary trust or by *inter vivos* trust as a supplemental benefits trust, and a self-settled trust funded with the assets of the disabled person, such as an inheritance or the proceeds of a personal injury action, as a special needs trust. Regardless of who creates the trust, the beneficiary will be disqualified from means-tested government benefits if the trustee’s discretion to use trust assets for the disabled beneficiary is not sufficiently limited or the trustee uses trust assets to purchase too many countable resources or provide the beneficiary with too much income or in-kind income.

There is no definitive explanation of what is a special need

or supplemental benefit. It is probably easier to determine what is *not* a special need or supplemental benefit. This does not include the basic necessities of life, such as food and shelter. Nor does it include gifts to friends or relatives, or insurance on the life of the disabled beneficiary, which will be a countable resource and will not benefit the beneficiary. Likewise, special needs or supplemental benefits would not include items or services that are available from public benefit programs, since the purpose of the trust is to maintain eligibility for those programs.

Generally speaking, both special needs trusts and supplemental benefits trusts are simply discretionary spendthrift trusts, but the myriad statutes and regulations governing means-tested public benefits programs affect these trusts in unique ways. As a result, it is not sufficient for a discretionary trust to merely restrict distributions if a beneficiary qualifies for public benefits. For example, New Jersey’s trust buster statute voids any will or trust provision that limits distributions for “health related goods and services” because of a beneficiary’s eligibility for Medicaid, and will render the beneficiary ineligible for Medicaid services unless the trust is established pursuant to 42 U.S.C.A. Section 1396p(d)(4)(A) or (C).¹ Accordingly, to advise clients properly in this area, the practitioner must understand both the laws governing the trusts and those public benefits programs the trusts are designed to preserve.

Special Needs Trusts

Special needs trusts are sometimes referred to as (d)(4)(A) or payback trusts because the federal authority for them is found at 42 U.S.C.A. Section 1396p(d)(4)(A) and contains a payback condition. The federal statute requires that although funded with the disabled person's assets, the trust must be established by the disabled person's parent, grandparent, or legal guardian, or by a court; the disabled individual may not be the grantor. Additionally, in order for the trust assets to be disregarded in determining public benefits eligibility: 1) the beneficiary must be under age 65 when the trust is established and funded; 2) the beneficiary must be disabled; and 3) the trust must provide that upon the death of the beneficiary any state agency that has provided Medicaid benefits (and in many jurisdictions, like New Jersey, other state-provided means-tested benefits) must be reimbursed out of the trust up to the amount of the benefits provided during the existence of the trust.

Another type of self-settled trust created with the funds of the disabled beneficiary that is disregarded in determining public benefits is the pooled trust. A pooled trust must be established and managed by a nonprofit organization that maintains a separate account solely for the beneficiary of each trust account, but for purposes of investment and management of funds, the trust pools these accounts. Unlike a (d)(4)(A) trust, a pooled trust account may be established by the disabled beneficiary; by the parent, grandparent, or legal guardian of the disabled beneficiary; or by a court.

On the death of the beneficiary, the nonprofit organization may retain some of the trust account funds and the state is repaid an amount equal to the total medical assistance paid on behalf of the beneficiary from the remaining balance of the account.²

In New Jersey, the Planned Lifetime Assistance Network of New Jersey

(PLAN/NJ), an organization originally established by the ARC of New Jersey, is the main nonprofit organization for pooled trusts. PLAN/NJ's pooled trust is approved by Medicaid and Social Security. On the death of a trust account beneficiary, PLAN/NJ retains 50 percent of the account balance to fund social services for other disabled clients, and the balance is used to reimburse Medicaid for benefits paid.

The definition of disability in the context of a special needs trust is the same as that contained in the Social Security Act and used to determine eligibility for SSI or Social Security Disability (SSD) benefits.³

An individual shall be considered to be disabled for purposes of this subchapter if he is unable to engage in any substantial, gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity).⁴

New Jersey statutes facilitate the establishment of special needs trusts to supplement the government assistance provided to disabled individuals.⁵ New Jersey regulations governing special needs trusts are found at N.J.A.C. 10:71-4.11(g), and in addition to the requirements set forth at 42 U.S.C.A. Section 1396p(d)(4)(A), mandate, *inter alia*, that the trust agreement state that:

- It is for the sole benefit of the disabled person. For expenditures made from the trust that provide incidental benefits to other persons, those other persons must contribute a *pro rata* share to the trust for such expenses associated with their benefit.

- The purpose of the trust is to supplement, not supplant, impair or diminish, any benefits or assistance of any federal, state or other governmental entity. If the trust provides for food or shelter, those expenditures are considered in-kind support and maintenance for SSI and Medicaid purposes.
- The trustee will fully comply with all state laws, including the Prudent Investor Act.⁶
- An annual formal or informal accounting of all expenditures made by the trust will be submitted to the appropriate public benefits agency.
- The state be given advance notice of any expenditure in excess of \$5,000, and of any amount that would substantially deplete the principal of the trust.
- Additions to trust *corpus* must be reported to the appropriate public benefits agency.
- If the disabled beneficiary is a minor, a court must approve the trust, and the trustee must execute a bond unless waived by the court. In the case of a minor or incapacitated disabled beneficiary, the trust assets must pass by intestacy; this does not violate the doctrine of worthier title.⁷ No further trusts may be created within the special needs trust.

Tax Treatment of Special Needs Trusts

For *income tax* purposes, the special needs trust is a grantor trust, meaning that the income of the trust generally is considered to be owned by the grantor. However, because the trust will be funded with the disabled beneficiary's assets, the IRS likely would characterize the parent, grandparent, legal guardian or court creating the trust as a "nominal grantor," and treat the disabled beneficiary as the true grantor for income tax purposes. Accordingly, the beneficiary would report all of the trust income on his or

her individual income tax returns regardless of whether trust assets are actually distributed to or for his or her benefit.⁸

Further in this regard, the transfer of a disabled son's share of his deceased father's IRA to a special needs trust by the son's guardian was not a sale or disposition and, therefore, not a taxable event. The special needs trust was considered a designated beneficiary, and the trustee of the special needs trust could calculate required minimum distributions to the special needs trust based on the disabled son's life expectancy.⁹

For *gift tax* purposes, a transfer of the disabled beneficiary's assets to a special needs trust should not constitute a completed gift, since during the trust's existence the assets held by it, along with the trust income, may be used only for the beneficiary's benefit. Consequently, there would be no gift tax imposed at the funding of the trust.¹⁰

Supplemental Benefits Trusts

A parent, spouse or other relative or third party who leaves a disabled individual his or her assets outright by will or living trust may jeopardize the disabled individual's eligibility to receive public benefits. To avoid that outcome, the will or living trust of a parent, spouse or other relative or third party can provide that the assets, including the home, if desired, be held in a supplemental benefits trust for the disabled individual's benefit. If the trust is not to be funded with assets of the beneficiary, then most of the federal and New Jersey requirements with respect to special needs trusts do not apply. Supplemental benefits trusts are private matters between the grantor or testator, the trustee and the beneficiary.

While the terms of a supplemental benefits trust are not mandated by law, the availability of trust assets to the disabled beneficiary will determine whether his or her eligibility for public benefits programs is compromised. If the benefi-

ciary has the right, authority or power to liquidate the property, the value of the property is counted as a resource for Medicaid eligibility purposes.¹¹ If a disabled beneficiary has legal authority to revoke a trust and then use the funds to meet his or her food or shelter needs, or direct the use of the trust principal for his or her support and maintenance under the terms of the trust, the trust principal is a resource for SSI purposes.¹²

Mandatory disbursements from a trust to a disabled beneficiary without restriction on the anticipation, assignment or sale of the right to future payments may also be a resource to the beneficiary. For example, if the trust provides for payment of \$100 per month to the beneficiary for spending money, absent a prohibition to the contrary, the beneficiary may be able to sell the right to future payments for a lump-sum settlement.¹³

Under the terms of a properly drafted supplemental benefits trust, the disabled individual has no control or access to the trust funds. As a result, the funds are not considered a resource available to the disabled individual for purposes of Medicaid, SSI eligibility or Division of Developmental Disabilities residential services.¹⁴ Anyone can continue to contribute funds to the trust. For example, relatives or friends of the disabled individual can make a gift by adding to the trust instead of making an outright gift to the individual.

An irrevocable trust funded with the assets of a third party for the benefit of a disabled individual: 1) is not a special needs trust subject to the federal requirements of 42 U.S.C.A. Section 1396p(d)(4)(A) or state requirements prescribed in New Jersey regulations at N.J.A.C. 10:71-4.11 (g), and 2) the trust assets and income are unavailable to the disabled beneficiary and are an excludable resource for Medicaid because a trustee other than the disabled beneficiary has sole discretion to disburse funds

and the disabled beneficiary cannot compel a distribution.¹⁵

Elderly parents concerned about Medicaid or other means-tested public benefits to cover the future costs of their own custodial care, may transfer their assets to protect them; however, such a transfer may compromise their own Medicaid eligibility for a period of time. An exception exists, however, for parents who transfer their assets to supplemental benefits trusts created for the sole benefit of their disabled child. Thus, parents confronting their own long-term care needs can protect assets for the lifetime care and support of their disabled child and access Medicaid benefits for themselves by transferring their assets to a trust created for the sole benefit of their disabled child.

Both federal and New Jersey law, as well as New Jersey regulations, define a transfer for the "sole benefit of" a disabled child as a transfer arranged in a way that no individual except the disabled child "can, in any way, benefit...at the time of the transfer, or at any time in the future" from the transferred assets.¹⁶ Federal law provides that no transfer penalties will apply if a trust created for the sole benefit of a disabled child is "actuarially sound" or has a "payback provision." New Jersey regulations are more restrictive than federal law, however, since New Jersey has added a requirement that the trust must contain a payback provision naming New Jersey as the first remainder beneficiary, regardless of actuarial soundness.¹⁷

The spouse (including a domestic or civil union partner) of a disabled individual also may wish to leave some or all of his or her estate in a testamentary supplemental benefits trust for the benefit of the Medicaid recipient spouse. If, however, the non-Medicaid spouse dies within five years of the receipt of assets from the Medicaid spouse, which are then used to fund the testamentary supplemental benefits trust and the Medicaid spouse subse-

quently dies within five years of that original asset transfer to the non-Medicaid spouse, Medicaid is entitled to a recovery claim against property held in the testamentary supplemental benefits trust.¹⁸

Separately, a testamentary supplemental benefits trust for the benefit of a surviving spouse is often funded with the portion of the deceased spouse's estate required to satisfy the spousal elective share pursuant to N.J.S.A. Section 3B:8-1. In fact, if a surviving spouse does not exercise his or her statutory right to the spousal elective share, the value of the elective share will be deemed a transfer of assets by Medicaid, subject to a penalty period of benefits ineligibility.¹⁹

The Appellate Division affirmed the trial court's finding that the failure to elect the spousal elective share constitutes a transfer of available resources for less than fair market value rendering the surviving spouse ineligible for Medicaid for a period of time.²⁰

Tax Treatment of Supplemental Benefits Trusts

For *income tax* purposes, an *inter vivos* supplemental benefits trust may be drafted as a grantor trust so the trust income will be reportable by and taxed to the grantor during his or her lifetime. One way to have the *inter vivos* supplemental benefits trust treated as a grantor trust, while not causing the trust to be included in the grantor's gross estate, is to give the grantor (in a non-fiduciary capacity) a right to reacquire trust *corpus* upon the substitution of other property of equivalent value.²¹

By structuring the *inter vivos* supplemental benefits trust as a grantor trust, a tax document (Form K-1) will not be issued to the disabled beneficiary when, as later discussed, assets are distributed to or for the disabled beneficiary's benefit. This should minimize confusion by any governmental or charitable agency or organization providing needs-based benefits regarding the income or

resources available to the beneficiary. Care must be taken, however, to ensure that the circumstances causing the trust to be treated as a grantor trust do not result in the inclusion of the trust property in the grantor's estate at his or her death, particularly if the grantor is expected to have a taxable estate (including the trust value) under federal or state law.

Following the death of the grantor, the *inter vivos* supplemental benefits trust will continue for the beneficiary's benefit as a non-grantor trust (*i.e.*, the trust will report its income, deductions and credits on its own income tax returns). Alternatively, an *inter vivos* supplemental benefits trust may be drafted as a non-grantor trust. Similarly, a testamentary supplemental benefits trust will be taxed as a non-grantor trust. An election may be taken to treat any non-grantor supplemental benefits trust as a qualified disability trust, and a deduction equal to the personal exemption amount under I.R.C. Section 151(d) (\$3,650 in 2009) will be permitted if all of the beneficiaries of the trust as of the close of the tax year are disabled as determined by Social Security. The trust may still qualify if the principal reverts to a person who is not disabled after the trust ceases to have any beneficiary who is disabled.²²

Further, as distributions are made to the beneficiary from a non-grantor trust, whether from income or principal, the beneficiary will be taxed on his or her proportionate share of distributable net income (DNI). To the extent that distributions from the trust do not equal net accounting income or are less than DNI, the trust will pay tax on accumulated income at the federal and state levels. Further, the trust will pay tax on short- and long-term capital gains. In the event that the trust incurs capital losses, and to the extent those losses are not applied to other current year gains, the losses will be used to reduce accumulated income, if any, to a maximum of \$3,000. Excess loss could be

carried forward to offset future income.

Any donor effecting a gift to an *inter vivos* supplemental benefits trust may be required to file a gift tax return. Generally, a donor may *not* use his or her annual \$13,000 (in 2009) exclusion from gift tax for gifts made in trust. If, however, the supplemental benefits trust is structured as a Crummey trust²³ by providing a limited withdrawal right in the gift, each contribution will be considered a present gift to the trust beneficiaries. The trust should be designed so far as possible so that the contributions made to it will not result in a taxable gift in the year made. Any contribution to the supplemental benefits trust to which the disabled beneficiary is given a Crummey withdrawal right would be considered available resources to that beneficiary, and may cause him or her benefits ineligibility at the time of the gift.

To ensure that a gift to the trust will not jeopardize the disabled beneficiary's benefits eligibility at the time of the gift, yet will qualify for the annual gift tax exclusion, the donor may specify that any or all trust beneficiaries, except for the disabled beneficiary, may exercise a withdrawal right over the gifted property. This will qualify the gift for the donor's annual exclusion to the extent that the gift does not exceed an amount equal to \$13,000 (in 2009) multiplied by the number of individual beneficiaries given a right of withdrawal, and will not jeopardize the disabled beneficiary's benefits eligibility.

The *inter vivos* supplemental benefits trust should provide withdrawal rights only to those beneficiaries permitted under *Estate of Cristofani v. Commr.*²⁴ and its progeny, and further should provide to those beneficiaries the notice and other requirements typically included in Crummey trusts.

Government Benefits Program Eligibility

It seems obvious that a person should not be entitled to qualify for means-tested

benefits while a beneficiary of a trust funded with significant assets, unless strings are attached. Those strings limit the amount of resources the beneficiary can own, and the amount of income he or she can receive. Thus, while assets in a properly drafted special needs trust or supplemental benefits trust are exempt from being counted when the beneficiary's eligibility is determined, how the trust assets are paid or applied for the beneficiary thereafter may well affect his or her eligibility. The trustee of a special needs trust or supplemental benefits trust must always be mindful of the resource and income limitations related to different programs for which the beneficiary may be eligible.

The means-tested government benefit programs for which a special needs trust or supplemental benefits trust is intended to preserve eligibility are typically welfare programs. The two programs most often accessed are SSI (a federal cash benefit program) and Medicaid (a joint federal and state health insurance program). An individual who qualifies for SSI automatically qualifies for New Jersey Medicaid without any further evaluation of his or her income and resources. If the beneficiary does not qualify for SSI, he or she may be eligible for benefits under the Medicaid Only, Medically Needy or NJ Care-Special Medicaid programs.

Although a comprehensive discussion of the resource and income limitations of SSI and Medicaid programs is beyond the scope of this article, the following discussion will assist the reader in understanding the nexus between the availability of trust assets and preserving public benefits program eligibility.

Resource

In general, SSI allows a single beneficiary to have, at any given time, no more than \$2,000 of countable resources. New Jersey has several Medicaid programs, including Medicaid

Only, Medically Needy, NJ Care and NJ WorkAbility, with a variety of limits on countable resources ranging from \$2,000 to \$20,000. However, there are certain resources the beneficiary can have that are not counted in determining eligibility. The most significant resources excluded by both SSI and Medicaid are:

- The beneficiary's principal residence.
- Household goods and personal effects to the extent that their total value does not exceed \$2,000.
- A vehicle to the extent that its value does not exceed \$4,500; *i.e.*, the fair market value in excess of \$4,500 is counted as a resource. If, however, the vehicle is necessary for employment; necessary for the medical treatment of a specific or regular medical problem; is modified for operation or transportation of a handicapped person; or is necessary because of climate, terrain, distance or similar factors to provide necessary transportation to perform essential daily functions, the vehicle is not counted regardless of its value.
- The value of property of a trade or business, which is essential to the means of self-support, is excluded as follows: 100 percent by SSI and up to \$6,000 by Medicaid.
- Non-business property that is essential to the means of self-support, up to \$6,000.
- Life insurance owned by an individual (and spouse, if any) if the face value does not exceed \$1,500.
- Burial spaces and certain funds up to \$1,500 for burial expenses or Medicaid will exclude prepaid funeral contracts, if irrevocable.

The Code of Federal Regulations provides more detailed information on SSI resources beginning at 20 C.F.R. 416.1201. New Jersey Medicaid regula-

tions provide more detailed information on Medicaid resources beginning at N.J.A.C. 10:71-4.1.

The purchase by the special needs trust or supplemental benefits trust of a resource that is not exempt from being counted will adversely affect the beneficiary's eligibility. SSI considers the countable resources of a minor beneficiary's parents (if they are residing in the same household with the beneficiary) and a married beneficiary's spouse when determining eligibility. Decisions about purchases of resources for minors or married beneficiaries must consider the countable resources of other members of the family as well. Even a countable resource of modest value, when added to the beneficiary's existing resources, may adversely affect the beneficiary's program eligibility. Every purchase of an asset must be considered carefully to determine its effect.

SSI Income

SSI is a monthly cash payment to an aged, blind or disabled beneficiary for food and shelter based on the federal benefit rate (\$674 in 2009) and a New Jersey supplement (\$31.25 in 2009). Thus, "income" is defined as anything the beneficiary can receive in cash or in kind that can be used to meet his or her needs for food and shelter. Any income the beneficiary receives diminishes the amount of the SSI payment. With few exceptions, *earned income*, such as wages, will reduce the SSI payment by somewhat less than 50 cents for every dollar received. *Unearned income* is all income that is not earned income, such as payments from a special needs trust or supplemental benefits trust.

With some exceptions, unearned income will reduce the SSI payment by 100 cents for every dollar of unearned income received. In-kind income is any food or shelter that is given to the beneficiary.²⁵ "Shelter" is defined to include room, rent, mortgage payments, real

property taxes, heating fuel, gas, electricity, water, sewerage and garbage collection services. Therefore, if the trust pays the beneficiary's rent, or pays a portion of the cost of the beneficiary's food for a month, the trust is providing in-kind income to the beneficiary. In-kind income will reduce the SSI payment by one-third, plus \$20.²⁶

New Jersey Medicaid Income

The Medicaid program for which an applicant is eligible (*i.e.* Medicaid Only or Medically Needy), will be determined by whether an applicant's fixed monthly income is above or below the monthly income cap (\$2,022 in 2009). If the individual applies for home-based Medicaid benefits, such as a community-based waiver program or assisted-living facility benefits, the beneficiary's income cannot exceed the monthly income cap; an applicant will be eligible for nursing home Medicaid regardless of whether his or her income is above or below the cap. In addition, there are separate income eligibility requirements for Medicaid Only benefits depending upon the beneficiary's living arrangement.

The calculation of income includes earned income, such as wages, and unearned income, such as pensions, Social Security and disability benefits, spousal support and inheritances. New Jersey regulations provide a list of third-party payments *not* counted by New Jersey Medicaid as income.²⁷

Common Trust Administration Issues

Funding Issues

A special needs trust must provide precise values of assets funding the trust, as required by New Jersey regulations, including the details of structured payments (*e.g.*, dollar amount, payment frequency and duration of payments), if applicable. Where a structured settlement is involved, a determination should be made regarding whether the

trust is the owner of the contract. If so, the contract will not be treated as an annuity for income tax purposes.²⁸ If, however, the contract is determined to be a "qualified funding asset," as defined in I.R.C. Section 130(d) (relating to certain personal injury awards), the contract will be treated as an annuity.²⁹

Initial funding of a supplemental benefits trust is typically made by a lump sum payment, although periodic additions may be made to the trust through lifetime giving or inheritances. Where periodic additions through lifetime giving are anticipated, rights of withdrawal (Crummey rights) should be incorporated into the trust agreement. As previously discussed, care should be taken, however, to exclude the beneficiary from serving as a Crummey beneficiary if he or she is receiving any means-tested government benefits, since the value of such a withdrawal right, whether or not exercised, may be deemed an available asset or subject the trust to recovery for benefits paid to the beneficiary.

The practice of making third-party additions to a special needs trust should be discouraged through the inclusion of appropriate language in the trust document, since the consequence is to subject to recovery assets that otherwise would not be subject to recovery. A separate trust, or gifts to the beneficiary for a specific special need, instead should be encouraged. If the trust does require repayment to the state upon termination of the trust, adding assets from a third party (such as the beneficiary's parents) will not destroy the efficacy of the special needs trust, provided no additions are made after the beneficiary attains age 65. It will, however, unnecessarily subject those added assets to the obligation to repay the New Jersey Medicaid program (or other state Medicaid program) when the trust terminates.

Where the trust has been established as the result of the court-supervised dis-

position of the proceeds of a judgment or compromise on behalf of a minor or incapacitated person, the trust should provide that additions will not be accepted unless prior court approval is received.

Since a supplemental benefits trust will not provide for repayment to the state upon termination of the trust, adding the beneficiary's assets will not protect the added assets from being treated as a disqualifying transfer and/or counted as resources of the beneficiary. Disqualification from means-tested government programs will likely result, because New Jersey regulations and federal law require the inclusion of a pay-back provision where assets of the beneficiary are used to fund the trust.

Purchase of a Vehicle

A vehicle used for transportation by a disabled beneficiary is not a countable resource for SSI or New Jersey Medicaid eligibility. Specially equipped vehicles, such as a van with a hydraulic lift or ramp to allow easy access to a wheelchair, are far more costly than other vehicles. As a result, a vehicle is a common purchase by a special needs or supplemental benefits trust. Some of the issues to be considered include who will hold title to the vehicle; the insurance on the vehicle; and who will pay for costs to maintain the vehicle, such as fuel, maintenance and registration.

Title may be a concern if family members other than the disabled beneficiary drive the vehicle. The trust is liable as an owner of the vehicle in the event of an accident. While it seems desirable that a vehicle purchased by a special needs or supplemental benefits trust be titled in the name of the persons possessing or driving the vehicle (*e.g.*, the parents or spouse of the beneficiary), if the vehicle is not titled in the name of the trust, the remainder beneficiaries or New Jersey Medicaid may argue that the trustee has improperly

diminished the trust by transferring assets to a third person.

A technique that may allow the trustee to avoid exposing the trust to unnecessary liability related to its ownership of the vehicle, while not diminishing the value of the trust or having the trust determined not to be for the sole benefit of the disabled beneficiary, is to purchase and register the vehicle in the name of the driver, but retain a security interest equal to the value of the vehicle.

Car insurance protects the beneficiary and the beneficiary's family, but it also protects the trust. Therefore, it is important that the vehicle be adequately insured. If the drivers are financially unable to do so, the trust can pay for the cost of insurance. These payments should be made directly to the insurer, and not in the form of reimbursement to: 1) the parents, if the beneficiary of the trust is a minor, or 2) the spouse, if the beneficiary is married, to prevent any deeming of income to the beneficiary.

To avoid having a government benefit program or a court presume that a vehicle purchased with assets of a special needs or supplemental benefits trust is actually used for the day-to-day transportation of the family members more than it is used for the transportation of the beneficiary, the transportation needs of the beneficiary should be ascertained and documented. Based on that information, if it is determined that the vehicle is used substantially to provide transportation to the disabled beneficiary's family, those individuals may be required to pay part of the cost of maintaining the vehicle.

Purchase of a Home

The purchase of a home by a special needs or supplemental benefits trust may be problematic from a benefits planning perspective. If the disabled beneficiary could purchase a home without jeopardizing his or her benefits, as previously stated, there is little reason why a special needs or supple-

mental benefits trust for the beneficiary should not be allowed to do so, since the trust is for the sole benefit of the disabled beneficiary. This is particularly true for a special needs trust created with the beneficiary's funds and providing for repayment of government benefits upon termination.

Providing shelter, however, gives the beneficiary in-kind income that may affect his or her benefits under SSI and Medicaid. The payment of a mortgage provides in-kind income so that purchases of homes should be made in cash, if possible.

Similarly, because there are regulations stating that payment of real property taxes and utilities will be considered the provision of in-kind income, efforts should be made to have the disabled beneficiary's parents or other family members residing in the home pay the taxes and utilities, or to have them paid utilizing the beneficiary's SSI payments. The family must be counseled, when the purchase of the home is first being considered, that these payments may affect the beneficiary's SSI. There is no impediment to the trust paying for the maintenance (*e.g.*, painting/repairs) of the home (to preserve its value as a trust asset) and insurance on the home (again, to preserve its value as a trust asset).

Alternatively, the home could be purchased in the name of the disabled beneficiary with the trust taking back a mortgage equal to the purchase price of the home. The trustee and beneficiary still would be confronted with the in-kind income issues previously discussed for special needs trusts; however, the value of the home in excess of the purchase price (fixed by the mortgage) would escape future recovery.

Courts may require purchases and sales of homes to be approved by the court in advance. At the time of a purchase or sale, the trust instrument and the court judgment creating or authorizing the trust (if the trust was created in that

manner) must be reviewed to determine if such a requirement has been imposed. The petition should ask the court to approve and effectuate any agreements with the family members regarding the payment of rent, taxes, utilities or other costs associated with the home.

The terms of the trust and the judgment creating or authorizing the trust must be checked to see if there is authority in the trust for other members of the family to live in the home rent free. If no such authority exists, court instruction should be sought, or there must be negotiation with family for payment of some rent (which can be offset in many cases by payments to the family for care provided to the disabled beneficiary as long as the care management is memorialized in a contemporaneous writing). Medicaid requires that the special needs or supplemental benefits trust provide that the parents and other family members of the beneficiary may be charged his, her or their *pro rata* share of rent, as required by the trustee or as required by Medicaid or another public assistance program. The purpose of this requirement is to ensure that the special needs or supplemental benefits trust is for the "sole benefit" of the beneficiary.

Funeral Expenses

While unpaid expenses of the trust, including final compensation to the trustee and his or her attorney, and final medical expenses may be paid from a special needs trust prior to any other distributions, generally the special needs trust may *not* permit burial expenses to be paid until Medicaid's right to reimbursement is satisfied. Special needs trust funds may be used to prepay funeral expenses for the beneficiary during the lifetime of the beneficiary.

Child Support Payments

Child support payments (including arrearage payments) are unearned income to a child for SSI purposes, *i.e.*

one-third of the amount of a child support payment made to or on behalf of a child is excluded from countable income.³⁰ New Jersey Medicaid also does not count as income one-third of amounts received as child support.³¹ As a result, two-thirds of child support payments are counted toward a disabled child's income and could render an otherwise SSI/Medicaid-qualified disabled child ineligible for benefits. If the parents of a disabled child divorce, child support payments could be made to a special needs trust. Since child support payments actually belong to the child, the special needs trust would be deemed self-settled and must meet payback requirements.³²

What Can the Trust Buy?

While there is no list of approved expenditures available to trustees when determining the best uses of trust funds, many items are not limited by federal or

state law. Electronics such as televisions, computers, software, personal music devices and keyboards can be purchased by a trust. Telephone, cable, newspapers and Internet services are also unrestricted. Trust funds can also be used to provide tuition and tutoring for the beneficiary.

Conclusion

A special needs or supplemental benefits trust can allow an incapacitated person to live with greater dignity by covering supplemental needs not met through government, charitable or other benefits. Selecting the trust or trusts appropriate for a particular client requires that the elder and disability law practitioner understand the differences between the various special needs and supplemental benefits trusts available and the tax and government benefits planning ramifications of each. Only with such knowledge can the elder and disability law practitioner properly draft the trust agreements required to meet the needs of his or her clients. Of course, drafting the trust is only the first step. Thereafter, a counseling relationship should be established with the trustee to assist with the handling of complex trust administration issues. ◊

Endnotes

1. N.J.S.A. 30:4D-6(f).
2. 42 U.S.C.A. §1396p(d)(4)(C).
3. 42 U.S.C.A. § 1396p(a)(2)(B).
4. 42 U.S.C.A. § 1382c(a)(3)(A).
5. N.J.S.A. 3B:11-36 and 37.
6. N.J.S.A. 3B:20-11.1 *et seq.*
7. N.J.S.A. 3B:11-37f.
8. Rev. Rul. 83-25.
9. Priv. Ltr. Rul. 2006-20025 (February 2006).
10. Treas. Reg. 25.2511-2(b).
11. 20 C.F.R. §416.1201(a). N.J.A.C. 10:71-4.1(c).
12. Social Security Administration Program Operations Manual System (POMS), SI 01120.200.
13. *Id.*

14. N.J.A.C. 10:71-4.1(c). 20 C.F.R. §416.1201(a). N.J.A.C. 10:46-1.3.
15. *A.M. v. Div. of Med. Assistance & Health Servs.*, HMA8525-05 (Final Agency Decision, June 26, 2006), http://lawlibrary.rutgers.edu/oal/sea_rch.shtml.
16. U.S. Dept. of Health and Human Services Health Care Financing Administration State Medicaid Manual (Trans. No. 64, Nov. 1994) and N.J.A.C. 10:71-4.10(b)8.
17. N.J.A.C. 10:71-4.10(f).
18. N.J.A.C. 10:49-14.1(n)3(ii). *Estate of Michael DeMartino v. Div. of Med. Assistance & Health Servs.*, 373 N.J. Super. 210; (App. Div. 2004), *certif. denied*, 182 N.J. 425 (2005).
19. N.J.A.C. 10:71-4.10(b)3ii.
20. *I.G. v. Dep't of Human Servs.*, 386 N.J. Super. 282 (App. Div., 2006).
21. I.R.C. § 675(4)(C).
22. 97 T.C. 74 (July 29, 1991).
23. *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968)
24. I.R.C. § 642(b)(2)(C)(ii).
25. 20 C.F.R. 416.1124. *See*, 20 C.F.R. §§ 416.1123, 416.1130 and 416.1140 for a discussion of how unearned income is counted and how in-kind support and maintenance is valued.
26. 20 C.F.R. §§ 416.1123, 416.1130 and 416.1140.
27. N.J.A.C. 10:71-5.3.
28. I.R.C. § 72(u)(1).
29. I.R.C. § 72(u)(3)(C).
30. POMS SI 00830.420.
31. N.J.A.C. 10:71-5.3.
32. 42 U.S.C. 1396p(d)(4)(A).

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