

## **Supplemental Needs Trusts**

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### **What is a Supplemental Needs Trust?**

A Supplemental Needs Trust (sometimes referred to as a “Special Needs Trust” or SNT) is a trust which provides for the financial support of an individual through discretionary distributions by a Trustee with the assets of the trust qualifying as exempt or unavailable resources for purposes of needs-based public benefits (e.g., Medicaid). The purpose of this article is to briefly describe the various categories and types of Supplemental Needs Trusts.

### **The Types of SNTs**

Supplemental Needs Trusts fall into two broad categories depending on the source of the assets being conveyed to the Trust. If the assets of the Trust are comprised of the beneficiary’s own assets, the trust is considered a “first party trust.” Often, a first party Supplemental Needs Trust is funded with assets coming to a beneficiary by way of a lawsuit or unexpected inheritance.

If, on the other hand, the assets of the Trust are comprised of a third party’s assets (such as a parent’s), the trust is considered a “third party trust.” Generally, trusts funded with assets of a spouse are considered first party trusts, except where the trust is testamentary (created in an individual’s Will).

#### **(a) Third Party SNTs**

The defining characteristic of a third party Supplemental Needs Trust is language which permits the Trustee to distribute to (or for the beneficiary’s benefit) amounts from the Trust in the Trustee’s discretion. The key term is the discretionary nature of distributions.<sup>1</sup> A Supplemental Needs Trust should not require the Trustee to make distributions to the beneficiary because the assets of the trust must be legally unavailable to the beneficiary in order for the Trust assets to be considered non-countable resources.

If, the theory goes, the beneficiary could go to court and compel the Trustee to make a distribution to him or her, then the beneficiary has an enforceable legal right to trust distributions, and the trust assets should therefore be counted as assets available to the beneficiary for purposes of determining public benefit eligibility.

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<sup>1</sup> Even trusts which grant the Trustee complete, absolute and unfettered discretion as to the amounts and timing of distributions are still controlled by a “reasonableness standard” and the Trustee must act in a way contemplated by the person who created the trust. See 2d Restatement of Trusts 187(j).

A trust which requires the Trustee (generally in the form of “shall distribute” language) to distribute for a beneficiary’s support or healthcare expenses may not qualify as a Supplemental Needs Trust. Similarly, a trust which requires the Trustee to distribute all income from the trust may not qualify as a Supplemental Needs Trust. Language which mandates distributions to a beneficiary can result in the beneficiary holding an enforceable legal right to demand distributions with the consequence of the Trust assets being considered non-exempt.

**(b) First Party SNTs**

First Party Supplemental Needs Trusts are tightly constrained by state and federal law. First Party Supplemental Needs Trusts are less flexible than Third Party Supplemental Needs Trusts. For this reason, it is always better for a parent to provide an inheritance to a disabled child in the form of a Supplemental Needs Trust created by the parent since it will qualify as a Third Party Supplemental Needs Trust. If the parent does not undertake this advance planning and the disabled child has to resort to a First Party Supplemental Needs Trust, there are fewer available options and less flexibility in drafting the trust.

There are three types of First Party (or “self-settled”) Supplemental Needs Trusts which advance Medicaid eligibility, each of which is briefly described below.

**(1) Payback Trust<sup>2</sup>**

The requirements for a Payback Trust are that (a) the beneficiary is disabled and under age 65; (b) the trust is established by a parent, grandparent, legal guardian or a court; and (c) the trust provides that upon the beneficiary’s death, the South Dakota Department of Social Services (DSS) must first be repaid its Medicaid lien before any other distribution is made from the trust.

A Payback Trust may not be established by the beneficiary himself/herself, the beneficiary must be under age 65 when the trust is funded, and the Medicaid lien must always be satisfied, at least to the extent that there are assets remaining in the trust at the beneficiary’s death.

**(2) Pooled Trust<sup>3</sup>**

The requirements for a Pooled Trust are that (a) the beneficiary is disabled; (b) the trust is managed by a nonprofit association which pools the investments but maintains separate accounts for each beneficiary; (c) the trust is established by a parent, grandparent, legal guardian, a court, or the individual; and (d) the trust provides that upon the beneficiary’s

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<sup>2</sup> ARSD 67:46:05:32:03(2). See also 42 USC 1396p(d)(4)(A).

<sup>3</sup> ARSD 67:46:05:32:03(3). See also 42 USC 1396p(d)(4)(C).

death, DSS must be repaid its Medicaid lien before any other distribution is made from the trust -- unless amounts are retained in the trust for the benefit of other beneficiaries.

In South Dakota, there is only one such trust, the Pooled Advocate Trust. See [www.pooledadvocatetrustinc.com](http://www.pooledadvocatetrustinc.com).

### **(3) Medicaid Income Trust<sup>4</sup>**

A Medicaid Income Trust is a trust which can only be composed of an individual's income such as pension and social security. The requirements of a Medicaid Income Trust are that (a) the trustee is required to pay all income, but not to exceed 300% of the maximum Social Security Income (SSI) standard, when added to any additional monthly income of the beneficiary; (b) the trustee is required to pay to the long term care provider or nursing home the amount of income remaining needed for care from DSS; and (c) it provides that upon the beneficiary's death, DSS must be repaid its Medicaid lien before any other distribution is made.

There is no requirement to pay back *other* public benefit programs (such as the Social Security Administration, the Veteran's Administration or Indian Health Services) for a Payback Trust, a Pooled Trust, or an Income Trust.<sup>5</sup> Only the Medicaid program asserts a "Medicaid lien" through its Estate Recovery program.

### **(4) Other First Party Trusts**

If a First Party Trust does not meet the definition of a Payback Trust, a Pooled Trust, or a Medicaid Income Trust, then the South Dakota Medicaid eligibility rules apply an analysis based on whether the trust is revocable (e.g., a living trust) or irrevocable (e.g., a charitable remainder trust or irrevocable life insurance trust).

#### **(a) Revocable First Party Trusts**

If a First Party Trust is revocable, the principal is considered an available resource to the individual and a payment from the trust is considered income. Stated another way, the rules essentially disregard the existence of revocable trusts and deem the individual to be the owner of all trust assets in determining Medicaid eligibility.<sup>6</sup>

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<sup>4</sup> ARSD 67:46:05:34:01. See also 42 USC 1396p(d)(4)(B).

<sup>5</sup> However, in the context of a lawsuit settlement, providers such as Medicare are addressed prior to the funding of the trust. There is also the concept of a "Medicare Set Aside Trust" which is beyond the scope of this article.

<sup>6</sup> ARSD 67:46:05:32:02.

### **(b) Irrevocable First Party Trusts**

As to irrevocable trusts, the South Dakota rule states; that if the trust “contains any provision under which payment from the trust may be made to or for the benefit of the individual, the entire portion of the principal or income on the principal from which payment to the individual could be made is considered a resource” and any income from the trust is considered income.<sup>7</sup>

This is a harsh rule.<sup>8</sup> It essentially provides that if there is any provision that allows the Trustee, to make a distribution from an irrevocable trust (which does qualify as one of the three recognized trusts described above), then DSS considers that amount of the trust available to the beneficiary – even if the Trustee has determined *not* to actually make the distribution.<sup>9</sup> For example, if the Trust states that the Trustee may distribute \$10,000 to the beneficiary of an irrevocable first party trust, and the Trustee elects not to make the distribution, the rule treats beneficiary as having constructively received \$10,000.

The rule would not apply to an irrevocable trust where the individual funding the trust retained no rights as a beneficiary whatsoever. If, for example, an individual funded an irrevocable trust for the sole benefit of her nieces and nephews, DSS would not deem the assets of the trust available to the individual. However, “transfer penalties” (discussed elsewhere) may apply depending on when the trust was funded.

### WHERE TO FIND THE LAW

The law is generally comprised of statutes, regulations and caselaw (reported opinions by a court to specific facts). The law cited within the above discussion can be found at the links provided in the “Law” section of the ThomasESimmons.com website. South Dakota statutes are abbreviated as “SDCL” for South Dakota Codified Laws. South Dakota administrative rules are abbreviated as “SDAR.” Federal statutes are abbreviated as “USC” for United States Code.

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<sup>7</sup> Id.

<sup>8</sup> When an individual is deemed ineligible for Medicaid because of the application of the harsh rules for trusts, DSS may waive its consideration of the trust as a resource if it can be clearly shown that all efforts have been made to recover assets placed in the trust, and the individual’s continuing care or well being is seriously threatened because of the ineligibility for Medicaid. ARSD 67:46:05:32:04. See also 42 USC 1396p(d)(5).

<sup>9</sup> See ARSD 67:46:05:32:02 (stating that these rules apply regardless of the purposes underlying the creation of the trust, “whether the trustee has or exercises any discretion under the trust, whether there are restrictions on when or whether distribution may be made from the trust, or whether there are restrictions on the use of any distribution from the trust.”).

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