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A Primer *on Special Needs Trusts*

IN NEW JERSEY

WHAT MAKES A TRUST A SPECIAL NEEDS TRUST (SNT)

A Special Concept

While there are different types of special needs trusts, they all share the common trait of maintaining eligibility for means tested government assistance programs such as Medicaid and Supplemental Security Income. In addition, special needs trusts also share the common trait of creating a fund that can be used to supplement the care and/or services provided by means tested programs.

To Better Understand a SNT, You Need to Understand Means Tested Programs

Although special needs trusts are premised on a relatively simple concept, the public assistance programs they protect introduce a significant amount of complexity. This complexity is introduced because there are multiple and various Medicaid programs, and each program has its own set of specific rules that determine eligibility. While an extensive examination of these programs is beyond the scope of this primer, it is important to realize that this complexity exists, and that it forms the context in which special needs trusts operate.



ELIGIBILITY FOR MEANS TESTED PROGRAMS

Level of Care

As a practical matter, the individual must meet the test of actually needing the care for which they apply. In focusing on special needs trusts, this primer assumes that level of care is not an issue and only examines financial eligibility.

Resource Test

In addition to meeting the applicable level of care, all means tested government assistance programs have resource limits which place caps on the individual's assets and income. While the income cap varies from program to program, the asset cap is more consistent and is generally \$2,000.00 for most programs. Certain assets, such as an ABLE account funded with less than \$100,000, and the individual's home and automobile, are not counted as available resources when determining eligibility. Most assets are counted, however, including assets that are owned by a person with a disability and controlled by a guardian. This even includes property held in restricted accounts that cannot be accessed without a court order. Without some planning or directed strategy, the individual will need to apply to a court to place assets in a SNT or consume all available resources and then apply, or reapply, for assistance after becoming impoverished.

Penalty Periods

If the individual transfers his or her assets for less than full fair market

value, a penalty period will be imposed during which the individual will be ineligible for government benefit programs. In most cases, this rule will apply retroactively for a period of five years from the date an application for benefits is submitted. In addition to penalty periods, everyone who accepts and receives public benefit programs has an affirmative duty to disclose any material change in his or her circumstances. If an individual fails to notify the agency that administers his or her program of a material change, the agency can later seek reimbursement for the benefits provided during any periods of ineligibility. In some cases, the agency may have a cause of action for fraud against the individual.

Traditional Trusts as an Available Resource for Eligibility in New Jersey

As a general rule, assets held in trust will normally be counted as an available resource without regard to the individual's specific program. Counting trusts as an available resource makes things very difficult for individuals and their families who want to attempt any sort of planning for future needs.

Revocable Trusts

Since the individual retains the legal authority to control the trust assets and/or revoke the trust instrument, a revocable trust is treated no differently than any other available asset. For example, an individual's revocable trust would be considered no differently than his or her savings or checking account.

Irrevocable Trusts

Since the individual does not retain legal control to revoke the trust, irrevocable trusts are treated differently than revocable trusts. The specific language in the trust will be carefully reviewed and evaluated according to two criteria.

First Criteria: Whether any portion of the trust can be used for the individual's benefit.

Potential payments

If any payment could be made, either to the individual or for the benefit of the individual, the portion that could be paid will be considered as an available resource.

Actual payments

Payments made to the individual, or made for the individual's benefit, will be considered income to the individual, and the income rules will apply.

Payments for any other purpose will be considered a transfer of assets for less than fair market value, and the transfer rules will apply.

Second Criteria: Whether any portion of the trust cannot be used for the individual's benefit.

When no payment can be made

Any portion of the trust from which no payment can be made, either to the individual or for the benefit of the individual, will be considered a transfer of assets for less than fair market value, and the transfer rules will apply.

Look Back and Penalty Periods in New Jersey

With irrevocable trusts, a look back period of five years applies instead of the normal three year look back period.



SPECIAL NEEDS TRUSTS AND ELIGIBILITY

A Narrow Exception to the Means Based Programs

Contrary to the rules in the section above, special needs trusts may provide a very narrow exception to the general rules that normally apply to trusts. More specifically, a properly drafted and administered special needs trust will not be counted as an available asset, and proper trust distributions will not be counted as income. To receive this special exception, however, the trust must meet certain statutory requirements and pass review by the agencies responsible for administering the trust beneficiary's public assistance programs.

Importance of Proper Administration of a SNT in New Jersey

While special needs trusts in New Jersey are conceptually simple and provide a narrow exception to the trust rules, the administration of a special needs trust can become very complex. Administration can become complex because the rules that regulate government assistance programs are complex and change over time. Every special needs trust must be administered to the specific rules of the trust beneficiary's individual government assistance programs.

Flexibility of Special Needs Trusts

The “special needs” that any given trust can provide will always be impacted by the technical requirements of each individual’s government assistance programs. Consequently, a particular distribution that does not violate one individual’s program requirements may cause serious problems for an individual receiving benefits from a program with different requirements. Despite this potential complexity, however, a properly drafted and administered special needs trust can be very flexible and can be adapted to meet program requirements even as those requirements may change over time.



TYPES OF SPECIAL NEEDS TRUSTS IN NEW JERSEY

Major Distinctions

Two major distinctions may be drawn among all special needs trusts. A special needs trust will be either a “Third Party Trust” or a trust created pursuant to the provisions of the Omnibus Budget and Reconciliation Act of 1993 (OBRA 93), commonly called a "First Party Special Needs Trust" or a "(d)(4)(A)" Trust. You may initially determine whether a special needs trust is a Third Party Trust or an OBRA 93 Trust by looking at the source of the assets used to fund the trust. If the assets used to fund the trust never belonged to the beneficiary, or if they are not deemed to belong to the beneficiary, then the trust is a Third Party Trust. In other words, Third Party Trusts will always be established by someone other than the beneficiary and with funds in which the beneficiary has no ownership interest.

Third Party Trusts in New Jersey

There are two general requirements for transforming a more traditional trust into a Third Party special needs trust. First, these trusts must be established by someone other than the trust beneficiary. Third Party Trusts are usually established by parents of adult children, grandparents, aunts, uncles, siblings, friends, or any other independent party with no legal duty to support the trust beneficiary. The second key requirement is that these trusts must be established with funds in which the beneficiary has no ownership interest. Third Party Trusts can be more easily adapted to the needs and wants of the person creating the trust and can therefore be part of a more traditional estate plan. They can be revocable or irrevocable, and most significantly, do not require any “payback provisions”. Payback provisions are explained in the last part of the section which follows immediately below.

Disability Trusts in New Jersey

These trusts are also referred to as (d)(4)(A) trusts (or "First Party Trusts"), which alludes to where they can be found in the Federal statute that authorizes them. Due to common usage, this is usually the type of trust most people are referring to when they use the term “special needs trust”. To establish a valid Disability Trust in New Jersey, it must satisfy the legal requirements that are set forth below in plain language.

The Trust must be established solely for the benefit of an individual who is disabled as defined by law and who is under 65 years of age.

The trust may only be established by the individual’s parent, grandparent, legal guardian, or a Court.

The Trust must be established with assets belonging to the individual.

Any funds that happen to remain in the Trust at the individual's death must be used to reimburse the State for medical benefits provided over the individual's lifetime. After Medicaid is repaid, any DDD lien must also be repaid. This requirement to reimburse the State is commonly referred to as a payback provision.

What About Pooled Trusts in New Jersey

These trusts are also referred to as (d)(4)(C) trusts. To establish a valid Pooled Trust, it must satisfy the legal requirements that are set forth below in plain language.

The Trust must be established and managed by a non-profit association.

The Trust must maintain separate accounts for each Beneficiary, but the funds are pooled for purposes of investment and management.

Each separate Trust account must be established solely for the benefit of an individual who is disabled as defined by law, and it may only be created by that individual, the individual's parent, grandparent, legal guardian, or a Court. There are no age restrictions or requirements.

The individual's account must be established with assets belonging to that individual.

Any funds that remain in an individual's account at that individual's death may be retained by the Trust. Any funds not retained by the Trust must be used to reimburse the State. This may be referred to as a modified payback provision.



THE ADVANTAGES IN NEW JERSEY OF USING A SPECIAL NEEDS TRUST

Advantages for the Trust Beneficiary

Eligibility for Government Assistance

If the individual is already receiving government assistance benefits, he or she should continue to receive an uninterrupted flow of services with no disruption or threat to the individual's well-being. If the individual is just applying for benefits, then initial eligibility can be attained because the special needs trust will prevent the assets from being counted in the application process. From time to time, technical modifications to the trust may be necessary. Once technical modifications are made, eligibility can be restored.

Reduced Cost

When medical providers contract with the State to provide Medicaid services, they agree to deliver those services at a significantly lower cost than if the beneficiary had to pay privately by spending down. Also, even if the special needs trust must eventually reimburse the State for services provided over the beneficiary's lifetime, reimbursement will be at this lower cost and will be free of any penalties or interest.

Supplemental Needs

Through the trustees' discretionary disbursements, the beneficiary has indirect availability to a fund that can provide for supplemental needs and greatly increase quality of life. Some examples of items that can drastically increase the beneficiary's quality of life include the following:

- Differentials in housing costs between shared and private rooms in institutional settings.
- Medical procedures or therapies not provided through government assistance.
- Supplemental nursing care and private companion services.
- Geriatric care services.
- Travel expenses.
- Entertainment expenses such as concerts, stereo, and other electronic equipment.
- Guardian Fees.
- Attorney Fees.
- Any other expense, service, or product not provided by the individual's government assistance program.

Maximizing the Benefit of a Structured Settlement in a New Jersey Special Needs Trust

In personal injury actions, combining a special needs trust with a structured settlement can provide a second level of protection for the beneficiary. The first level of protection is provided through the structured settlement's ability to shield the settlement proceeds from the undue influence of new-found "friends" as well as from any of the beneficiary's own spendthrift propensities. Additionally, the special needs trust can provide a second level of protection by receiving the structured payments in such a way as to preserve eligibility for government

assistance. In turn, this allows the structure's periodic payments to be maximized to the greatest extent possible.

Preservation of Choice for the Beneficiary

The beneficiary can use Medicaid or make arrangements with the trustee to pay for medical services not provided by Medicaid or for a specialist who doesn't accept Medicaid payments. You can't do this anymore. Without regard to the beneficiary's actual decision in any given case, however, the important point is that the beneficiary's ability to make such a decision is preserved.

THE DISADVANTAGES IN NEW JERSEY OF USING A SPECIAL NEEDS TRUST

Trust Assets Restricted in New Jersey

The main disadvantage of a special needs trust is that the individual, and/or the individual's family, cannot have unrestricted access to the trust assets. While trust beneficiaries and their families sometimes see this initially as a disadvantage, this restriction generally works for the individual's best interest. Restricting trust assets is essential to protecting government assistance eligibility, it provides for greater financial security, and it allows the assets to be managed in a more efficient and secure manner.

Difficulty Selecting a Trustee

In some situations, selecting an appropriate trustee can present problems.

Family members are often considered as the first choice, but family members often lack the objectivity and sophistication to fulfill the duties of a fiduciary in even the best of circumstances. Professional trustees are available to a limited degree, and the benefit that professionals can provide should be discussed along with the cost for such services. Whether professional or not, however, it is crucial for the trustee to know and understand all of the rules that govern public assistance programs because protecting eligibility for these programs is central to the trustee's duty. Two non-profits will sometimes agree to serve; they are PLAN-NJ and ARP, G_ C_. Pooled Trust arrangements can often be a very effective solution to the problem of selecting a trustee because Federal law requires the non-profit association to manage the Pooled Trust that it establishes.

Trust Assets Subject to New Jersey State Lien

Because First Party Special Needs Trusts must have payback provisions, New Jersey's lien must be satisfied at the beneficiary's death. Thus, one disadvantage of using a special needs trust is that trust assets cannot usually be passed on to the beneficiary's family. One exception to this disadvantage, however, is when a Third Party Trust is used. Because Third Party Trusts are funded with assets that do not belong to the trust beneficiary, these trusts do not require payback provisions. See "*Helping a Special Needs Grandchild*". However, even when using a special needs trust that does contain payback provisions, any assets that remain after satisfying the State's lien can be passed on to the beneficiary's heirs. In addition, there is no requirement that any assets remain in the trust at the person's death.



PRACTICAL ISSUES AND CONSIDERATIONS

New Jersey's State Liens

As a condition to receiving Federal money for its Medicaid programs, each of the States must submit a State plan to the Federal government for approval. As part of these State plans, each State must have some method or procedure for attempting to seek repayment for medical benefits paid to Medicaid recipients. In New Jersey, the State plan includes the two specific recovery methods that are described below.

Third Party Lien

New Jersey law creates a recovery lien which most often becomes applicable in personal injury actions. Under this Act, which states that Medicaid should be the payor of last resort for medically necessary goods and services furnished to Medicaid recipients, the recipient must reimburse the State for all Medicaid benefits provided as a direct result of the incident that gave rise to the cause of action. Reimbursement must come from the settlement award, and the use of a special needs trust will not defeat the State's third-party lien. *In other words, the third party lien should be satisfied before funding the special needs trust.*

Estate Recovery

New Jersey created the Medicaid Estate Recovery Act. Under this Act, the State has a claim against the Medicaid recipient's probate and non-probate estate for all Medicaid benefits provided from age 55 forward. A special needs trust will not escape the application of the Estate Recovery

Act. The requirement that all special needs trusts contain a payback provision ensures that the trustee has an affirmative duty to satisfy the State's lien at the beneficiary's death.

Minimum Amount Necessary to Establish a Special Needs Trust

There is no technical or legal requirement that sets any minimum necessary amount to establish a special needs trust. However, if the individual receives any amount over the typical asset cap of \$2,000.00, the receipt of these assets will have a negative effect on program eligibility. Whether the individual should create a special needs trust, or spend down the assets on goods or services, is a decision that the individual must make after consultation with competent counsel. Without regard to the individual's ultimate decision, a plan of action should be implemented immediately so that program eligibility is preserved.

Duty to Notify New Jersey

All recipients of government assistance have an affirmative duty to notify the agency that is responsible for administering their program whenever there is any material change in circumstances. Becoming the beneficiary of a trust is a material change in circumstances, and the individual must provide the agency with a copy of any First Party trust document. Local legal counsel for the agencies will review the trust to see if it meets all of the technical and legal requirements for being treated as a special needs trust and therefore not counted as an available resource.



GLOSSARY OF NEW JERSEY TRUST TERMS

Special Needs Trust – a general term that denotes any one of several specific trusts, all of which preserve eligibility for government assistance benefits and create a fund that can be used to supplement the beneficiary’s care and quality of life.

Third Party Trust – a trust that is established by someone other than the trust beneficiary and with funds in which the beneficiary has no ownership interest. Examples of third parties could include the parents of adult children, grandparents, aunts, uncles, brothers, sisters, cousins, friends, or any other independent party with no duty of support. One principal advantage of these trusts is that they do not need to contain payback provisions, which means that assets can be passed on to other family members at the trust beneficiary’s death free of any State liens.

First Party or Disability Trust – a trust established for the sole benefit of the trust beneficiary by the beneficiary, and beneficiary’s parent, grandparent, legal guardian, or a court. The beneficiary must be under 65, the assets used to fund the trust must belong to the beneficiary, and any remaining assets at the beneficiary’s death must be used to reimburse the State.

Pooled Trust – a trust established and administered by a non-profit association with trust sub-accounts established for the sole benefit of the individual beneficiaries by the beneficiary’s parent, grandparent, legal guardian, a court, or the individual beneficiary. The beneficiary does not need to meet any age requirement, the assets used to fund the trust must belong to the beneficiary, and any remaining assets at the beneficiary’s death must either be retained in the trust by the non-profit or used to reimburse the State for all medical benefits provided to the beneficiary.

Medicaid. Refers to all of the various needs based State programs that are operated in conjunction with the Federal government. New Jersey has numerous different adult Medicaid programs intended to provide different benefits and meet different needs. Like Supplemental Security Income (SSI), Medicaid programs have income and asset limits that must be satisfied and maintained as a condition to receiving program benefits. While Medicaid asset limits are fairly consistent, income limits can vary considerably from program to program.

Medicare. Provides health insurance for the aged and for individuals determined to be disabled. Unlike Medicaid, Medicare is a social insurance program, not a means tested program. It consists of two components, Part A and Part B. Part A provides inpatient hospital coverage, skilled nursing home care, and home health care. Part B provides inpatient hospital services, out-patient hospital care, physical therapy, medical equipment, and prosthetic devices. Part B is voluntary, and a small monthly premium must be paid to maintain enrollment.

OBRA Trusts. Trusts created pursuant to legislation passed under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) and codified at 42 U.S.C. §1396p(d). OBRA Trusts include (d)(4)(A) Trusts, also called Disability or special needs trusts; (d)(4)(B) Trusts, also called Income or Miller Trusts; and (d)(4)(C) Trusts, also called Pooled Trusts.

Patient Responsibility. A term that is applicable when someone is receiving Medicaid benefits under the Institutional Care Program, which is the Medicaid program in Florida that helps pay for long term nursing home care. Everyone who receives long term care benefits is responsible for paying a portion of the overall cost. The portion that each person must pay, or their “patient responsibility”, is determined by adding all gross

income together and then subtracting a personal needs allowance of \$35.00. The individual receiving long term care benefits must pay his or her patient responsibility each month, and Medicaid pays the remaining balance.

Social Disability Income (SSDI). An entitlement program that operates very much like Social Security old age and retirement benefits because eligibility is partially based on paying into the system for an appropriate number of quarters. Assuming that a sufficient number of quarters have been paid, receipt of SSDI benefits is then conditioned on a determination of disability by the Social Security Administration rather than upon reaching retirement age.

Special Needs / Supplemental Needs. Refers to services and/or goods that are not provided by the trust beneficiary's public assistance program. Because this definition of special needs is directly related to the technical eligibility requirements of each public assistance program, trust distributions that are perfectly appropriate for one trust beneficiary may be entirely inappropriate for a different trust beneficiary who receives different public assistance benefits.

Supplemental Security Income (SSI). A needs-based Federal program that is administered by the Social Security Administration. The determination of disability that the Social Security Administration must make is the same determination that is made for SSDI. Unlike SSDI, however, SSI has income and asset limits that must be satisfied and maintained as a condition to receiving program benefits. In many States, including New Jersey, eligibility for SSI automatically qualifies the individual for ABD Medicaid benefits.

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