University of South Dakota School of Law

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2012

Estate Planning for Individuals with Disabilities

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Available at: https://works.bepress.com/tom_simmons/29/

ESTATE PLANNING FOR THE DISABLED

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Originally Published by NBI as materials for Trusts 101 (2012)

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I. Introduction

The basic federal safety net program for elderly, blind and disabled persons is Supplemental Security Income (SSI). The Social Security Administration (SSA) administers the program and eligibility is based upon financial need. The basic eligible criteria are that an individual have less than two thousand dollars ($2,000) in assets, or three thousand dollars ($3,000) for a couple, although certain limited resources are excluded.

There are also income limitations that individuals must satisfy to qualify for SSI.

SSI's sister in welfare benefits is the Medicaid (Title 19) program. While SSI is entirely a federal program, Medicaid, which shares the same basic eligibility requirements[1], is a program governed by both federal and state statutes and regulations. Medicaid provides for payment of medical expenses including long term care costs which are not covered by Medicare (with certain limited exceptions) or most private health insurance.

Eligibility for Medicaid, being a needs-based benefit, depends on at least three primary facts: (1) the individual applicant's resources; (2) the individual's income; and (3) whether the individual has made any gifts or transfers within certain time periods which result in a period of ineligibility for benefits. The resources, income and gifts attributable to the applicant's spouse are also considered.

Individual eligibility determinations for Medicaid include an analysis of any trusts to which the individual is a beneficiary.[2] There are two basic kinds of trusts which fall under two different analytical rubrics for eligibility purposes, self-settled trusts (trusts which the individual or the individual's spouse has funded) and third party trusts (trusts funded by a third party).

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[1] See A.R.S.D. 67:46:05:30 ("The resource limit, including both liquid and nonliquid resources, for long-term care assistance is $2,000 for an individual and $3,000 for an individual with a spouse.").

[2] A comprehensive overview or summary of the precise rules for Medicaid eligibility are beyond the scope of these written materials. It should be noted that although the Deficit Reduction Act (DRA) of 2006 changed many of the rules of Medicaid eligibility including extending the look-back period for gifts, none of the amendments altered the provisions regarding how trusts are treated.

II. Third Party Special Needs Trusts

Creating a trust for another person is much easier than creating a trust for oneself insofar as Medicaid eligibility is an objective. The reason that self-settled trusts do not generally result in Medicaid eligibility benefits is found at A.R.S.D. 67:46:05:32:02 which applies to self-settled trusts. Even when a self-settled trust is irrevocable, "and contains any provisions 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 . . ." A.R.S.D. 67:46:05:32:02 (emphasis supplied).[3]

Third-party special needs trusts are not considered an available resource to an individual applying for Medicaid so long as (1) the beneficiary has no power to compel distributions; (2) the assets in the trust can only be used for the beneficiary's supplemental needs and not for support; (3) the trust has one lifetime beneficiary; and (4) the trust is irrevocable.[4] The pertinent South Dakota Medicaid rule states:

> If the individual, the individual's spouse, or someone, including a court or administrative body, authorized to act on behalf of the individual or the individual's spouse has the legal power to dissolve the trust or invade the principal and use the proceeds, the principal of the trust is considered a resource.

A.R.S.D. 67:46:05:32. Generally, the trustee of a third-party special needs trust will be governed by a distribution standard such as the following:

> This Trust is for the sole benefit of the Beneficiary. Distributions may be made for the Beneficiary's supplemental needs only. No part of a principal or income of this Trust may be distributed so as to replace any public assistance benefits for which the Beneficiary may be eligible. Distributions for the benefit of the Beneficiary shall be limited so that the Beneficiary is not disqualified from receiving public benefits to which the Beneficiary would otherwise be entitled. If the Trustee should expend or distribute from the Trust property, such expenditure shall only be made on behalf of the Beneficiary over and above those benefits and resources paid for by or available from the Department of Social Services of the State of South Dakota, and/or other local, county, state, tribal, or federal agency or department, including those benefits and resources which are currently available or in the future may become available. The Grantor urges the Trustee to, in the exercise of the Trustee's unfettered discretion, and consistent with the intent of the Trust, to make distributions which will permit the Beneficiary's dignity and grace, enhance the Beneficiary's day to day existence, and allow said Beneficiary the highest possible development of the Beneficiary's abilities. All distributions are vested in the Trustee's sole, absolute, and unfettered discretion. The Trustee may, consistent with the terms hereof, not make any distributions to the Beneficiary if the Trustee deems such to be in the Beneficiary's best interests. The Trustee's sole and independent judgment, rather than any other person's determination, is intended to be the criterion by which distributions for the Beneficiary's benefit are made. No court or any other person should substitute its or their judgment for the discretionary decision or decisions made by the Trustee with regards to distributions for the benefit of the Beneficiary. This is not a support trust, it is for the Beneficiary's supplemental care needs only.

Third party special needs trusts need not contain any "payback" provision. The Grantor of the Trust may provide that upon the Beneficiary's death, any remaining trust assets are to be distributed to other family members, charities, or the Grantor himself/herself.

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[3] A self-settled trust is defined at A.R.S.D. 67:46:05:32:01 and includes trusts created by an individual's spouse (although testamentary trusts are excluded).

[4] Clifton B. Kruse, *Third Party and Self-Created Trusts: Planning for the Elderly and Disabled Client* at 37-43 (ABA 2nd ed. 1998).

III. Self-Settled d4 Trusts (First Party Trusts)

Whenever a trust is created by the individual Medicaid applicant or the applicant's spouse, a quite different set or rules applies.[5] Any "self-settled" trust is subject to two different sets of rules, depending on whether the trust is revocable (such as a living trust) or irrevocable.[6]

If the trust is revocable, then the principal of the trust is considered an available resource to the Medicaid applicant. Any payments from the trust to or for the benefit of the individual is considered income (and may disqualify the individual from Medicaid based upon the monthly income limitations). Furthermore, any other payments made from the trust (other than trustee fees or legal expenses) are deemed to be gifts which may result in a penalty period for Medicaid eligibility.[7] In other words, a revocable trust established by an individual who is applying for Medicaid is inherently disadvantageous and arguably even worse than no trust at all.

On the other hand, if the trust is irrevocable, then the following analysis applies:

> If the trust . . . contains any provisions 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. . .

A.R.S.D. 67:46:05:32:02. Payments of income are considered income and any other payments made from the trust (other than trustee fees or legal expenses) are deemed to be gifts with potentially disqualifying consequences.[8] One additional draconian rule applies to irrevocable trusts established by Medicaid applicants or their spouses: The Department of Social Services considers any part of the trust from which payments to the individual cannot be made to have been transferred to the trust for purposes of establishing Medicaid eligibility, thereby triggering a second period of ineligibility.[9]

In view of these rules, self-settled trusts, whether revocable or irrevocable, which permit any distributions whatsoever for the benefit of the Medicaid applicant do nothing to advance the eligibility of the individual for Medicaid benefits.

However, there are four very specific exceptions to these self-settled trust rules.

(1) Medicaid Income Trusts

A Medicaid Income Trust has limited availability since it can only be composed of the beneficiary's own pension, social security or other income.[10]

(2) Under-65 Payback Trusts

An "Under-65 Payback Trust" is an irrevocable trust which meets the following requirements:

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[5] A.R.S.D. 67:46:05:32:01.

[6] A.R.S.D. 67:46:05:32:02.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] A.R.S.D. 67:46:05:33:01(1); see also 42 U.S.C. § 1396p(d)(4)(B).

(1) The beneficiary must be disabled[11] and under age 65[12];
(2) The trust must be established by a parent, grandparent, guardian or a court; and
(3) The trust must provide that upon the beneficiary's death and before any other distribution is made from the trust, the Department of Social Services is reimbursed up to the total amount of Medicaid benefits advanced during the beneficiary's lifetime.[13]

This type of trust is often referred to as a "(d)(4)(A) Trust" because it is described at that particular subsection with 42 U.S.C. § 1396p. It is also commonly referred to as a "Payback Trust" on account of the mandatory "payback" to the Department of Social Services upon the beneficiary's death.

(3) Pooled Trusts

A "Pooled Trust" is an irrevocable trust which meets the following requirements:

(1) The beneficiary must be disabled[14];
(2) The trust must be established by a parent, grandparent, guardian, the court, *or* the individual himself/herself;
(3) The trust must provide that upon the beneficiary's death and before any other distribution is made from the trust, the Department of Social Services is reimbursed upon to the total amount of Medicaid benefits advanced during the beneficiary's lifetime *unless* assets are "retained by the trust"[15];
(4) The trust must be established and managed by a nonprofit association; and
(5) The trust must maintain sub-accounts for each individual but may pool the accounts for investment purposes.[16]

This type of trust is sometimes referred to as a "(d)(4)(C) Trust." The Pooled Advocate Trust established and managed by Pooled Advocate Trust, Inc. is South Dakota's first qualifying pooled trust. See PooledAdvocateTrustInc.com.

Although a pooled trust has additional requirements (pooled investments and a nonprofit manager), it offers greater flexibility in terms of a modified payback requirement and the ability of the individual themselves to establish the trust. The Department of Social Services recently amended their regulations to penalize transfers to a pooled trust by individuals age 65 or older; the matter is in litigation at the time these materials were prepared.

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[11] The definition of "disabled" is found within the Social Security Act. 42 U.S.C. § 1382(a)(3).

[12] The trust, if created and funded prior to the beneficiary's 65th birthday, can continue for the beneficiary's benefit after the 65th birthday, but no additional contributions can be made to a payback trust after the beneficiary attains age 65.

[13] A.R.S.D. 67:46:05:32:03(2); *see also* 42 U.S.C. § 1396p(d)(4)(A). Payment of taxes and reasonable administrative expenses associated with the termination of the trust may be made but payment of debts to third parties or of funeral expenses are not allowed.

[14] *See supra*, note 11.

[15] The "retained by the trust" language has been interpreted to mean that assets in a sub-account may be re-distributed among other beneficiaries of the trust in order to avoid the "payback" requirement. If the trust assets exceed the amount owing to the Department of Social Services, the Department can be repaid with the remainder distributed to individually named heirs or charities.

[16] A.R.S.D. 67:46:05:32:03(3); 42 U.S.C. § 1396p(d)(4)(C).

Self-settled trusts which do not qualify as d4 trusts do not advance Medicaid eligibility. In fact, transfers to a non-d4 self-settled trust can result in the imposition of a penalty period during which Medicaid eligibility is denied, even if the applicant otherwise qualifies.

(4) Undue Hardship

Finally, the draconian trust rules and very limited and specific exceptions may be softened in certain circumstances "if the individual can clearly show that all efforts have been made to recover assets placed into the trust and the individual's continuing care or well-being is seriously threatened because of the ineligibility for long-term care assistance."[17] This "undue hardship" exception is of limited applicability and puts the burden on the Medicaid applicant.

There are several situations in which a disabled person should consider establishing a trust which falls within the narrow exceptions carved out in the Medicaid eligibility rules. These situations involve a disabled person with excess resources who would otherwise qualify for Medicaid assistance if those resources could be contributed to a trust:

~ Unexpected inheritances;
~ Lawsuits settlements or recoveries; and
~ Long-term care recipients.

In most circumstances, where an individual is otherwise appropriate for a self-settled trust, the pooled trust option is the most appropriate.

IV. Guardianships

In South Dakota, a "guardian" is a person appointed by a court to be responsible for the personal affairs of an individual while a "conservator" is a person appointed by a court to be responsible for managing the estate and financial affairs of an individual.[18] (In other jurisdictions, there may be a similar distinction between a "guardian of the person" and a "guardian of the estate.")

In many cases, both a guardian and conservator are appointed and one individual may serve both roles. In other cases, the guardian is a different person than the conservator, while in still others there may be a guardian appointed but not a conservator, or vice versa. The law also permits co-guardians and co-conservators to be appointed.

A person for whom a guardian/conservator is appointed is either a minor (an individual under the age of eighteen) or a "person in need of protection."[19] (In other jurisdictions, a "person in need of protection" may be referred to as a "ward" or "incompetent.")

In this article, the use of the word "guardian" includes a "conservator." This article omits discussion of minor's guardianships.

The Need for Guardianships

A guardianship may become necessary when a disabled child turning eighteen, or when an adult experiences dementia or a traumatic brain injury and powers of attorney were not executed prior to incapacity. A guardianship vests a guardian with the legal power to make decisions on behalf of the person in need of protection, and grants the guardian the power to manage the individual's assets and property.

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[17] A.R.S.D. 67:46:05:32:04.

[18] SDCL 29A-5-102(2), (4).

[19] South Dakota also recognizes "Veterans' Guardianships." SDCL ch. 33-17A.

Guardianships are legal proceedings governed by state, not federal, law. The guardianship statutes in South Dakota are based upon the Uniform Guardianship and Conservatorship Act, a set of laws which is intended to be largely uniform among the states which adopt it.

The guardianship act is found in chapter 29A-5 of South Dakota Codified Laws.

Who Can Serve as a Guardian?

Four types of persons can serve as a guardian: (1) an adult individual who is capable of providing an active and suitable program of guardianship; (2) a public agency or nonprofit corporation; (3) a bank or trust company authorized to provide trustee services; (4) the South Dakota Department of Human Services or Department of Social Services if there is no one else qualified and willing to serve. No one can serve as a guardian who is employed by a public agency or facility which is providing substantial services or financial assistance to the person in need of a guardianship.[20]

When a Guardianship May be Unnecessary or Unavailable

A guardian can be appointed only when the person in need of protection has had his or her ability to respond to people, events, and environments impaired to such an extent that he or she lacks the capacity to meet the essential requirements for health care, safety, habilitation, or therapeutic needs without the assistance of a guardian.[21]

A conservator can only be appointed when the person in need of protection has had his or her ability to respond to people, events and environments impaired to such an extent that he or she lacks the capacity to manage property or financial affairs or to provide for their own support (or the support of legal dependents) without the assistance of a conservator.[22]

If the court is not satisfied that the individual is not sufficiently impaired to warrant a guardianship, then a guardianship will not be available. The law presumes every individual to be competent, and that presumption must be affirmatively overcome with a statement from a physician before a guardianship can be ordered. In some circumstances, the court will order a "limited guardianship" which vests the guardian with only certain enumerated responsibilities, leaving the protected person with authority over certain aspects of their life.

A guardianship may be unnecessary if the person in need of protection has no assets, or the assets can be managed without a guardianship.

V. Living Wills

Another term for a "living will" is an "advance directive." A living will is a statement or direction to your healthcare providers regarding certain forms of life-sustaining treatment in the event you are unable to make or communicate a healthcare decision and you are either terminal or vegetative and unlikely to recover. Essentially, a living will is a direction to your doctor to "pull the plug" under certain circumstances where you would be unable to verbally give that instruction.

Who can make a living will?

To make a living will, a person must be at least eighteen (18) years old and competent at the time the document is signed. A living will can be revoked so long as the individual retains competency.

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[20] SDCL 29A-5-110.

[21] SDCL 29A-5-302.

[22] SDCL 29A-5-303.

What are some of the problems with a living will?

One problem that can arise with a living will is the uncertainty about the occurrence of the triggering events. A living will is inoperative unless the individual is both (a) incompetent; and (b) either permanently vegetative or incurably terminal. There are many grey areas that can exist when the real world interacts with the words on the page of a document. The most famous instance of this occurred in the *Schaivo* case. There,

It's also not unusual for a healthy individual to feel that severe medical problems will so drastically affect quality of life so as to make artificial means of life support unnecessary and unwanted. Healthy individuals will often say, for example, "I never want to have to live on machines." But when a traumatic medical event actually occurs, many aggressively cling to life and hope for recovery even when the odds are clearly against them.

VI. Powers of Attorney

A "power of attorney" is a document where one individual -- the "principal" -- names another person -- the "agent" -- with the legal power to act on his or her behalf. A power of attorney document is usually notarized and may also be witnessed. Powers of attorney are revocable documents.

Who can make a power of attorney?

To make a power of attorney, the principal must be at least eighteen (18) years old and competent at the time the power of attorney is signed. A "durable" power of attorney is one which continues to be effective even if the principal later becomes incapacitated. A power of attorney can be made effective immediately upon signing, or its effectiveness can be deferred until the principal experiences an incapacity (a "springing" power of attorney).

What are some of the problems with a power of attorney?

The immense powers which are granted by a general power of attorney can be abused by an agent, and there is generally very little oversight or supervision of an agent who is acting during his or her principal's incapacity. For this reason, the use of powers of attorney should be approached with care and caution.

The alternative to powers of attorney for a disabled person or a minor is a court-supervised conservatorship proceeding.

VII. Wills and Estate Plans for Individuals with Disabilities

An individual of "sound mind" at least eighteen years of age may make a Will.[23] The courts have defined sound mind, for purposes of testamentary capacity, as someone who *without prompting*, is able to comprehend the nature and extent of his property, the persons who are the natural objects of his bounty and the disposition that he desires to make of such property.[24] The South Dakota Supreme Court has articulated this three-part test for the ability of an individual to execute a Last Will and Testament:

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[23] SDCL 29A-2-501.

[24] Estate of Berg, 783 N.W.2d 831 (SD 2010). The South Dakota Supreme Court has never defined the natural objects of a testator's bounty. Some courts have limited that designation to those who will inherit unless a will exists (e.g., determining that nephews, nieces, brothers, sisters and other collateral heirs are not natural or normal objects of a testator's bounty because of such relationships alone). Other courts have noted that collateral heirs, such as brothers and sisters, are not 'natural objects of bounty' as that term is used in the interpretation of wills, and therefore, where the next of kin are collaterals and one or more are unprovided for in the will, the pretermitted persons, in order to establish that the instrument is unnatural, must show affirmatively that they had peculiar or superior claims to the decedent's bounty; and, if no such claim is adduced, the instrument cannot be held to be unnatural. *Id.*

South Dakota law recognizes that an individual with a disability – even an individual under a guardianships or conservatorship – may still have capacity to make a Will. However, where an individual with disabilities lacks the capacity to make a Will, South Dakota allows a conservator to – with the approval of the Court – make a Will or other estate planning decisions on behalf of the protected person.[25] In appropriate circumstances, a conservator-made Will or revocable trust on behalf of a protected person should be carefully considered.[26]

VIII. Conclusion

There are many important considerations when undertaking an estate plan for an individual with disabilities. Every estate plan should be as unique as the person for whom it is created.

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[25] SDCL 29A-5-420. In doing so, the Court is directed to "primarily consider the decision which the protected person would have made, to the extent that decision can be ascertained." *Id.* The Court is also directed to consider "the financial needs of the protected person and the needs of legal dependents for support, possible reduction of income, estate, inheritance or other tax liabilities, eligibility for government assistance, the protected person's prior pattern of giving or level of support, the existing estate plan, the protected person's probable life expectancy, the probability that the conservatorship will terminate prior to the protected person's death, and any other factors which the court believes pertinent." *Id.*

[26] *See* Bruce S. Ross, *Conservatorship Litigation and Lawyer Liability: A Guide Through the Maze*, 31 Stetson L. Rev. 757 (2002) (discussing California's conservator-made Will legislation, which, along with South Dakota, was the first state to enact such laws).