

Special Trusts For Special Folks: SSI, Medicaid, & Tax Issues in Virginia Special Needs Trusts

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I. Checklist Of Medicaid Issues Related to Trusts.

A. General Rules For Medicaid Eligibility.

1. Individuals must be U.S. citizens with proof of identity and citizenship.³
2. Virginia residence is required for Virginia Medicaid eligibility. Residence of persons above the age of 21 is established by living in Virginia with the intent to remain in Virginia or with employment in, or the intent of seeking employment in, Virginia.⁴
3. Virginia offers Medicaid payment to "categorically needy," and "medically needy" Virginia citizens⁵ who are not otherwise ineligible for participation in the Medicaid program.⁶
 - a. Categorically needy class generally consists of aged (65 or over), blind, or disabled (ABD) individuals who meet certain conditions. The most commonly encountered are ABD individuals who receive Supplemental Security Income (SSI), and who meet Virginia's more restrictive Medicaid

¹ By nature, public benefits vary. The rules which apply to them change often. The present work is believed to be current through the date stated at the bottom of each page of this outline. Policy for the United States Supplemental Security Income (SSI) program is found at the Program Operations Manual System (POMS), <https://secure.ssa.gov/apps10/poms.nsf/partlist!OpenView>. Policy for the Virginia Department of Medical Assistance Services (Medicaid) program is found at the Virginia Medicaid Manual, http://www.dss.virginia.gov/benefit/medical_assistance/manual.cgi. The writer intends to maintain current links at his website, www.majette.net.

² Certain information is highlighted as an aid to the reader. Generally, such information is time sensitive, and serves as a caveat to check the primary sources for current data and policy directives.

³ Va. Medicaid Manual § M 0220.

⁴ Va. Medicaid Manual § M 0230.203. Different Medicaid policy applies for persons under the age of 21, institutionalized persons, etc.

⁵ Va. Medicaid Manual § M 0310.02.

⁶ Persons who are convicted of Medicaid fraud, who refuse to pursue certain support obligations for children, etc., are generally ineligible for Medicaid benefits. Va. Medicaid Manual § M 0210.100.

eligibility criteria);⁷ ABD individuals in nursing homes with less than three times the SSI level of income;⁸ and to ABD individuals whose income is less than 80% of the federal poverty level.⁹

- (i) 80% of the federal poverty level is \$784 per month as of January, 2014.¹⁰
- b. The "optional categorically needy" category includes persons who are eligible but have not applied for SSI or an optional state supplement¹¹, patients in an intermediate care facility operated in a Virginia Department of Mental Health, Mental Retardation, and Subsistence Abuse Services facility whose incomes are less than 300% of the SSI level,¹² persons who receive Medicaid approved community-based personal care and whose income is less than 300% of the SSI level;¹³ and ABD individuals receiving Auxiliary Grant¹⁴ benefits to paid to persons living in assisted living facilities licensed pursuant to Title 63.2 of the Virginia Code.¹⁵
 - (i) The SSI rate is \$721 per month as of January, 2014.¹⁶
 - (ii) The monthly income limit for Virginia public mental health hospitals, and also for several waiver related programs (MR, CBC) is 300% of the SSI rate, or \$2,163 as of January, 2014.¹⁷
- c. The "medically needy" category includes the aged, blind, or disabled person who would receive SSI except that his or her income exceeds a certain level. Medicaid coverage for this group is based on the so called "spend-down." The spend-down is an ongoing payment of "excess" income (i.e., income over a permissible limit) for incurred medical expenses.
 - (i) The spend-down is often confused with the exhaustion of assets that is sometimes required before an applicant is impoverished enough to qualify for Medicaid. **The two are not related.**
- d. ***Pending and Speculative as of March, 2014.***

⁷ Va. Medicaid Manual § M 0320.201.

⁸ Va. Medicaid Manual § M 0320.203.

⁹ Va. Medicaid Manual § M 0320.210.

¹⁰ Va. Medicaid Manual § M 0810.002. See <http://aspe.hhs.gov/poverty> for annually adjusted limitations.

¹¹ 42 C.F.R. § 435.210 (1989).

¹² 42 C.F.R. § 435.211, 1005. Va. Medicaid Manual § M 1430.102 D.

¹³ Va. Medicaid Manual § M 0320.204.

¹⁴ An auxiliary grant benefit is a cash payment made to certain aged, blind or disabled individuals who receive benefits under Title XVI of the Social Security Act, as amended, or would be eligible to receive these benefits except for excess income. Va. Code § 63.2-100.

¹⁵ An assisted living facility is a congregate care residential facility which provides assisted living care, a level of service for adults who may have physical or mental impairments and require at least a moderate level of assistance with activities of daily living. It is not a nursing home. *Id.*

¹⁶ See <http://www.ssa.gov/OACT/COLA/SSI.html>.

¹⁷ Va. Medicaid Manual § M 0810.002.

- (i) The Virginia General Assembly, at a budget impasse at the conclusion of the regular session in March, will return in a Special Session in April, 2014, to consider the Governor's wish to expand Medicaid coverage.¹⁸
- (ii) If coverage is expanded, assets and resources will be largely disregarded for non-long term care Medicaid services.

4. Long-term Care Coverage.

- a. Medicaid is available in medical facilities furnishing nursing facility services.¹⁹
- b. Medicaid is also available in Department of Mental Health and Mental Retardation facilities in accordance with special limitations.²⁰

B. General Financial Requirements.

1. Income Limitations. There is no strict income limit for persons receiving nursing care services in private nursing facilities.
 - a. When a nursing home resident has income in excess of the SSI level, he is a medically needy Medicaid recipient.
 - b. His income affects the amount of "patient pay" required - i.e., the amount the individual must contribute to the cost of care.
 - c. Otherwise eligible residents in Virginia public mental facilities (i.e., generally residents of state hospitals under the age of 22 or over the age of 65) are eligible only if their income does not exceed 300% of the monthly

¹⁸ "Virginia's fight over Medicaid expansion shifts from Capitol to cities, towns, rural enclaves," Washington Post, March 12, 2014, http://www.washingtonpost.com/local/virginia-politics/virginias-medicaid-war-shifts-from-capitol-to-cities-and-towns-across-the-commonwealth/2014/03/12/00df81f0-aa05-11e3-b61e-8051b8b52d06_story.html, accessed 2014-03-15, 6:52 AM.

¹⁹ 12 VAC 30-50-20 (categorically needy nursing home services without limitation), 60 (medically needy nursing home services without limitation). Va. Medicaid Manual § M 1850.100 D.

²⁰ "An IMD is a hospital, nursing facility or other institution with more than 16 beds that is primarily engaged in providing diagnosis, treatment or care, including medical attention, nursing care and related services, to persons with mental diseases. A facility for the mentally retarded is NOT an IMD." Va. Medicaid Manual § M 0280.100.

Virginia residents over the age of 65 are eligible for Medicaid reimbursement for their care while in an institution for treatment of mental diseases (IMD) if they: (1) receive such care and treatment in a specified medical or surgical center, intensive psychiatric center, skilled nursing facility, intermediate care facility, or intermediate care facility for the mentally retarded within in a Virginia public mental facility; (2) meet the resource limitations and transfer of resource policies described below, and (3) if their income does not exceed 300% of the SSI income limit. Va. Medicaid Manual § M 0280.200.

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SSI rate.

2. General Resource Rules. Applicants/recipients may have the following amounts in "*countable*" resources. A "countable resource" is any property which is not excluded from consideration by the Virginia Medicaid Plan or Virginia Medicaid Manual, and which a person owns, has the right, authority or power to convert into cash, and which the person is not legally restricted from using for support and maintenance.²¹
 - a. An individual may retain \$2,000.00. A couple may retain \$3,000.00 if both apply.
 - b. When one spouse is admitted to a nursing facility and the other remains in the community (defined as anywhere that is not "institutionalized"), the spouse in the community – the *community spouse* - is entitled to retain a "Community Spouse Protected Resource Amount."²²
 - c. The spouse in the nursing facility – the *institutionalized spouse* - is entitled to retain \$2,000.00.
 - d. Eligibility based upon resources is determined for each calendar month. Resource eligibility exists for the entire calendar month if countable resources were at or below the resource limit at any time in the month.²³

C. Whose Assets Fund The Trust?

1. Property which is transferred without adequate compensation (i.e., transferred into a trust for less than what Medicaid deems fair value) is presumed to have been transferred for purposes of qualifying for benefits under Medicaid, and generally results in the disqualification of the transferor for a specified period of time dating from the month in which the transfer is made.
2. The disqualification period is for Medicaid long term care services.²⁴

²¹Medicaid Manual, S1110.100 (B).

²²The rules for the calculation of the CSRA are inherently complex and often the subject of Medicaid appeals. Va. Medicaid Manual § M 1480.

Creation of a trust for a child under the age of 21, or a disabled child of any age, for the nursing home spouse should be considered, but only after suitable provision has been effected for the community (well) spouse under the spousal impoverishment rules generally found at Va. Medicaid Manual § M 1480.

²³Medicaid Manual, M1100.001 (B)(1).

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- a. "Long term care services" includes nursing home and "waivered" home health care services under the Virginia Medicaid plan.
3. If the transferor is married, the transferor and the transferor's spouse are *each* made ineligible by reason of a disqualifying transfer of assets.²⁵
 - a. Exception.
 - (i) Transfers made by the community spouse *after* eligibility has been established will not affect the eligibility of the institutionalized spouse.²⁶
 - (ii) However, purchase of a non-qualifying annuity even after eligibility has been established *can* disqualify the institutionalized spouse.²⁷
 4. If the Medicaid applicant or recipient (or the transferor's spouse) is entitled to property which he fails to take, such as through a disclaimer,²⁸ he is treated as having made a transfer of such property.

D. Who Is The Medicaid Applicant Or Recipient?

1. If the transferor into the trust is not the Medicaid applicant or recipient, or his surrogate, the anti-transfer rules will not apply to the transferor.
 - a. Surrogates for purposes of asset transfers under 42 USC 1396p / 12 VAC 30-40-300 (F) are:
 - (i) the individual's spouse,

²⁴ 42 U.S.C. § 1396p(e)(1); 12 VAC 30-40-300(F); Va. Medicaid Manual § M 0210.100 G ("An individual who transferred assets: to become or remain eligible for Medicaid, who did not receive adequate compensation, and who did not meet one of the asset transfer exceptions is ineligible for Medicaid payment for long-term care services for a specified period of time unless adequate compensation is received before the time period is over"); Medicaid Manual § M1450.

²⁵ 12 VAC 30-40-300 (E)(2) provides that "[a]n institutionalized individual who disposes of, or whose spouse disposes of, assets for less than fair market value on or after the look-back date specified in subdivision 2.b. shall be ineligible for nursing facility services, a level of care in any institution equivalent to that of nursing facility services and for home or community-based services furnished under a waiver granted under subsection (c) of §1915 of the Social Security Act." The corresponding policy provides, "[w]hen an institutionalized individual is ineligible for Medicaid payment of long-term care services because of a transfer made by the spouse, and the spouse is or becomes institutionalized and eligible for Medicaid, the penalty period must be apportioned between the spouses. *The couple may choose to either: • have the penalty period, or the remaining time in the penalty period, divided between the spouses, or • assign the penalty period or remaining penalty period to one of the two spouses.*" Va. Medicaid Manual § M 1450.640 F.

²⁶ Va. Medicaid Manual § M 1450.400 F.

²⁷ Va. Medicaid Manual § M 1450.400 G.

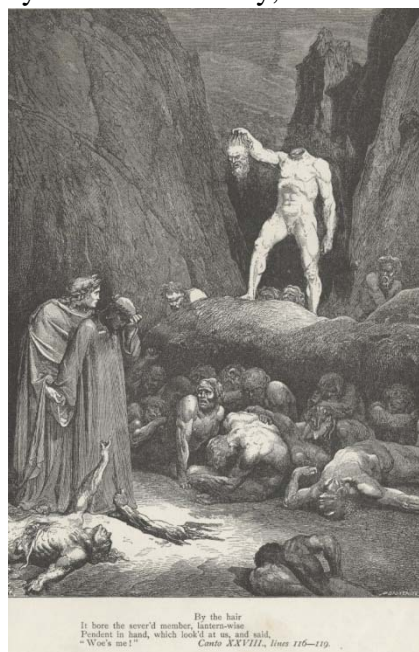
²⁸ Id. (E)(1), definition of "Asset" for purposes of transfers of assets.

- (ii) any person, including a court or administrative body, with legal authority to act in place of or on behalf of the individual or the individual's spouse, or
- (iii) any person, including any court or administrative body, acting at the direction or upon the request of the individual or the individual's spouse.²⁹

b. *Crummey* withdrawal power *caveat*: Don't Have Your Head Handed To You.

- (i) A *Crummey* power is the right, usually of the beneficiary, to take property from a trust.

- (ii) The power is required in order to meet the "present interest" element of a gift for the annual gift tax exclusion. When the holder of the power fails to exercise it, a gift is nevertheless imputed to the holder, and the donor of the property to the trust qualifies for the annual exclusion equal to the value of the property over which the power is given.



- (iii) Failure to take available property from a trust pursuant to a *Crummey* power is construed as a transfer of assets by the holder of the power for Medicaid purposes.³⁰

- (iv) When a *Crummey* power is required for gift and estate tax purposes, the trust should provide the power to a remainder beneficiary or some third party.

2. If the transferor into the trust, or the spouse of the transferor, is or may become a Medicaid applicant or recipient, the anti-transfer rules will be applied to the transferor upon the creation of *any* irrevocable trust.

²⁹42 USC 1396p (e) (1), definition of "Asset," and 12 VAC 30-40-300 (E)(1), definition of "Asset" for purposes of transfers of assets. Va. Medicaid Manual § M 1450.003 B, .200 B.

³⁰12 VAC 30-40-300 (F)(1), definition of "Asset" for purposes of the regulation.

E. When Does The Transferor Apply For Medicaid?

1. The "look-back date" is the first date of a period during which Medicaid may scrutinize the transfers of assets made by a Medicaid applicant or recipient.
2. Transfer to an irrevocable trust sets a 60 month look-back from the date on which the applicant applies for Medicaid benefits.³¹

F. Who Can Be Made Medicaid Ineligible By *Establishment* Of The Trust?

1. The *transferor* can be rendered ineligible if assets are transferred to a non-exempted trust is by reason of the *act* of transferring assets into the trust.
2. The *spouse of the transferor* can be rendered ineligible if the trust is not exempted under the Virginia Medicaid plan by reason of the *act* of transferring assets into the trust.

G. Who Can Be Made Medicaid Ineligible By Reason Of The *Existence* Of The Trust?

1. The *beneficiary* (who is not also the transferor) can be rendered ineligible based upon the *availability* of the trust assets to him. This can be avoided by providing the trustee with total discretion in the administration of the trust and a specific instruction to consider public benefits as a resource to be protected by the trustee in the exercise of such discretion.³²
2. See *Crummey* discussion above with respect to powers over an otherwise exempt trust.

H. How Does The Transfer Of Assets Into A Trust Affect The Medicaid Applicant?

1. Federal law requires that property transferred into a trust for sixty months before (and at any time after) an institutionalized person files an application for Medicaid be reviewed by DMAS to determine whether the transfer renders the transferor, or the transferor's spouse, disqualified for Medicaid payment of long term care services for a certain period of time.

³¹ Va. Medicaid Manual § M 1450.003 I.

³² Trust assets in a completely discretionary trust are exempt as resources to the beneficiary because they are not resources for him in the first place. "If an individual does not have the legal authority to revoke the trust or direct the use of the trust assets for his/her own support and maintenance, the trust principal is not the individual's resource." Va. Medicaid Manual § S 1120.200 D.

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2. The period of time for which the applicant must disclose transfers is referred to as the "look-back" period.³³
3. At least for civil purposes, a "transfer" is considered to be made by any action that reduces or eliminates the applicant's ownership or control of an asset. Included are gratuitous transfers, sales, disclaimers, transfers of income, etc. Transfers may be made by the applicant, and, depending upon the date of the transfers, will be deemed to have been made by the applicant even if made by the applicant's spouse, a joint owner of an asset, a court or administrative body with legal authority to act in place of the applicant, or any other person acting at the direction of, or upon the request of, the applicant or his spouse.³⁴
4. In analyzing the transfer DMAS presumes that a transfer of a resource for less than the fair market value was for the purpose of establishing Medicaid eligibility.
 - a. Subjective statements of ignorance are insufficient.
 - b. To rebut the presumption, the applicant must demonstrate by "convincing evidence" that the purpose of the transfer was wholly one other than qualifying for Medicaid.³⁵

I. Who Can³⁶ Be Prosecuted For A Criminal Act In The Creation Of The Trust Under The Health Insurance Portability And Accountability Act Of 1996 And The Balanced Budget Act Of 1997?

1. Section 217 of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) amended 42 U.S.C. § 1320a-7b, "Criminal penalties for acts involving Medicare or State health care programs," to make the "knowing and willful dispos[itions] of assets in order for an individual to become eligible for medical assistance" a criminal act "if disposing of the assets results in the imposition of a period of ineligibility for such assistance under section 1917(c)." Under Section 218 of HIPAA, the criminal provision became effective on January 1, 1997.
2. In August, 1997, Section 4734 of the Balanced Budget Act of 1997 amended the statute by repealing the criminal penalty as applied to persons *making* the transfer of assets and *imposing* it upon any person who, "for a fee knowingly and willfully *counsels or assists* an individual to dispose of assets (including

³³42 U.S.C. § 1396p; 12 VAC 30-40-300; Medicaid Manual § M1450.500 et seq.

³⁴42 U.S.C. § 1396p(e)(1); 12 VAC 30-40-300; Medicaid Manual § M1450.500 et seq.

³⁵Va. Medicaid Manual § M 1450.400 B.

³⁶As of this revision, there is no case law of any person successfully prosecuted under this provision of the law known to the writer.

by any transfer in trust) in order for the individual to become eligible for medical assistance under a State plan under title XIX [Medicaid], if disposing of the assets results in the imposition of a period of ineligibility for such assistance under section 1917 (C). Section 4734 became effective on August 5, 1997.

3. When it initially enacted HIPAA, Congress failed to proscribe criminal conduct in the statute. While the statute described intent and conduct (knowingly and willfully transferring assets), it failed to proscribe the conduct in the part of the statute that penalizes the behavior, subsections (i) and (ii). The 1997 revision to the statute corrected the error in subsection (ii) of the statute by including "provision of counsel or assistance" by any person who "for a fee ... knowingly and willfully counsels or assists" a third person to dispose of assets in order for the individual to become eligible for medical assistance."
4. The statute permits the *act* of transferring assets to obtain eligibility for Medicaid while it criminalizes *communication* of a statement that the law permits such transfers.
5. Constitutional concerns were raised early in connection with the criminalization of the transmission of legal advice, and the generally ambiguous language of the statute.³⁷
6. In March, 1998, Attorney General Reno opined that the statute was unconstitutional and informed Congressional leadership in both chambers that she would not defend the same.³⁸

³⁷See *Peebler v Reno*, 965 F. Supp 28 (Dist. Ore. 1997) (dismissed on standing grounds, but containing position by the United States Attorney General to the effect that transfers made within the "look-back" period but beyond the date of calculated ineligibility do not trigger the statute); *Appointment Of A Guardian Of Betty Gersten*, 661 N.Y.S.2d 943 (Sup.Ct. 1997) (criticizing over reliance on *Peebler* but permitting transfer of assets by guardian regardless of HIPAA).

³⁸Text of March 11, 1998 Letter from Attorney General Janet Reno to then Speaker of the House of Representatives Newt Gingrich: "I am writing to you regarding Section 1128B(a)(6) of the Social Security Act, as amended by Section 4734 of the Balanced Budget Act of 1997, which was signed into law on August 5, 1997. This is to respectfully inform you that, after close and careful scrutiny of the matter, the Department of Justice will not defend the constitutionality of Section 1128B(a)(6) because the counseling prohibition in that provision is plainly unconstitutional under the First Amendment and because the assistance prohibition is not severable from the counseling prohibition. Because Section 4734 repealed the provision just quoted, the new Section 1128B(a)(6) of the Social Security Act would prohibit attorneys and other professional advisors from "counsel[ing]" their clients to engage in an estate-planning strategy that itself is lawful. Under these unique circumstances, and in light of the fact that, pursuant to this provision, professional advisors such as attorneys would be prohibited from providing truthful, non-misleading advice to their clients about lawful behavior, we are unable to identify a governmental interest that would justify this restriction on protected speech. Accordingly, we believe that the "counseling"

7. On April 7, 1998, in *New York State Bar Association v. Reno*, case number 97-CV-1760, the United States District Court for the Northern District of New York issued a preliminary injunction preventing the United States, its agents, servants, employees, attorneys, and all persons in active concert and participation with Attorney General Reno, from commencing, maintaining, or otherwise taking action to enforce 42 U.S.C. § 1320a-7b(a) (6). The injunction has since been made permanent.
8. Apart from the constitutional issues, the statute itself states that that persons who receive a fee for counsel or assistance in effecting a transfer may only be subjected to the penalty when such a transfer will "result in the imposition of a period of ineligibility for such [Medicaid] assistance." Transfers which do not result in the imposition of ineligibility are not sanctioned.³⁹
9. Under the statute, only those dispositions made within a "look-back" period, and which are not specifically exempted, constitute a basis for disqualification.
10. Transfers for less than fair market value cannot cause a period of Medicaid ineligibility or exposure under the statute are as follows:
 - a. Transfers occurring *before* the 60 month "look-back" date (42 U.S.C. § 1396p(c)(1)(A)), as defined in 42 U.S.C. § 1396p(c)(1)(B)(i), (ii), cannot be the basis for a period of ineligibility.
 - b. Dispositions occurring *within* the "look-back" period but which are expressly exempted by the state's Medicaid plan⁴⁰ and the federal statute cannot cause a period of ineligibility.
 - c. Transfers to any person or trust stated at 42 U.S.C. 1396p (c)(2)(B) do not trigger a penalty. Thus, assets which:
 - (i) were transferred to another [Trustee?] for the sole benefit of the individual's spouse;
 - (ii) were transferred from the individual's spouse to another [Trustee?] for the sole benefit of the individual's spouse;

prohibition in Section 1128B(a)(6) of the Social Security Act plainly is unconstitutional under First Amendment, and cannot survive judicial scrutiny. Sincerely, Janet Reno"

³⁹42 U.S.C. § 1396p(c)(4) provides that "[a] State (including a State that has elected treatment under section 1902(f) [42 U.S.C. § 1396a(f)]) may not provide for any period of ineligibility for an individual due to transfer of resources for less than fair market value except in accordance with this subsection."

Dispositions that cause (and do not cause) imposition of periods of ineligibility are defined in the state plan (see State Plan for Medical Assistance Relating to Transfer of Assets and Treatment of Certain Assets, 12 VAC 30-40-300), and generally in 42 U.S.C. § 1396p, "Liens, adjustments and recoveries, and transfers of assets." In addition, Virginia, in accordance with other provisions of the federal law, has a detailed list of assets that may be disposed of for purposes other than to qualify for medical assistance, found in the Medicaid Manual M1450.400.

⁴⁰See 12 VAC 30-40-300 F.

- (iii) were transferred to, or to a trust (including a trust described in (d)(4)) established solely for the benefit of, the individual's blind or disabled child described in subparagraph (A)(ii)(II), or
- (iv) were transferred to a trust (including a trust described in subsection (d)(4) of this section) established solely for the benefit of a disabled individual under 65 years of age.

11. 42 U.S.C. § 1396p(C) (2) and the applicable portion of the Virginia Medicaid Plan⁴¹ provides that an "individual shall not be ineligible for medical assistance by reason o paragraph (1) (i.e., transfers made after the look-back date) to the extent that:

a. the assets transferred were a home and title to the home was transferred to

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- (i) the spouse of such individual;
- (ii) a child of such individual who is under age 21,
- (iii) (with respect to States eligible to participate in the State Program established under title XVI [42 U.S.C. § 1381 et seq.]) is blind or permanently and totally disabled, or (with respect to States that are not eligible to participate in such program) is blind or disabled as defined in Section 1614 [42 U.S.C. § 1382c]
- (iv) a sibling of such individual who has an equity interest in such home and who was residing in such individual's home for a period of at least one year immediately before the date the individual becomes an institutionalized individual; or
- (v) a son or daughter of such individual (other than a child described in clause (ii)) who was residing in such individual's home for a period of at least two years immediately before the date the individual becomes and institutionalized individual, and who (as determined by the State) provided care to such individual which permitted such individual to reside at home rather than in such an institution or facility;

b. the assets [**including but not limited to a home**]

- (i) were transferred to the individual's spouse or to another for the sole benefit of the individual's spouse;

⁴¹Id., (E.) (3), (3)(g).

- (ii) were transferred from the individual's spouse to another for the sole benefit of the individual's spouse;
- (iii) were transferred to, or to a trust (including a trust described in subsection (d)(4)) established solely for the benefit of, the individual's child described in subparagraph (A)(ii)(II), or
- (iv) were transferred to a trust (including a trust described in subsection (d)(4)) established solely for the benefit of an individual under 65 years of age who is disabled (as defined in section 1614 (a)(3)) [42 U.S.C. § 1382c(a)(3)].

II. Third Party Trusts.

A third party trust is a trust in which the settlor of the trust and the contributor of the assets funding the trust is ***not*** the same as the *beneficiary* of the trust.

A. Testamentary Spendthrift Trust.

1. Testator's Medicaid Implications.

- a. 42 U.S.C. § 1396p (d)(2)(A) expressly applies to, and limits only, trusts created "other than by will."⁴² A testamentary trust is thus exempt from payback requirements otherwise generally imposed upon exempt trusts under the federal statute.
- b. However, Virginia Medicaid estate recovery from the testator's estate will reduce the assets which may fund the testamentary trust.⁴³
 - (i) When the testator is a Medicaid recipient with a potentially large estate recovery claim an *inter vivos* (d)(4)(A) trust, even with the mandatory payback provision for the beneficiary's Medicaid claim, is advantageous.

⁴²12 VAC 30-40-300-(E)(3)(b).

⁴³42 U.S.C. 1396p (b). 12VAC30-20-140. Estate recoveries. A. General. Under the authority and consistent with the requirements of the Social Security Act §1917, the Commonwealth recovers certain Medicaid benefits when they have been correctly paid on behalf of certain individuals. The Commonwealth seeks recovery for all services which have been paid for consistent with the coverage and reimbursement policies in the State Plan for Medical Assistance.

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- (ii) Example: chronically ill, institutionalized grandparent wishes to benefit disabled grandchild; if the grandparent does not transfer the property from his estate during lifetime, Medicaid will recover its payments from the same (usually a home) *before* the testamentary trust is established, leaving little for the grandchild. In contrast, establishment of a (d)(4)(A) trust during the lifetime of the grandparent avoids estate recovery and protects more resources for the disabled grandchild.

2. Beneficiary's Implications.

- a. Availability of the trust principal or income depends upon the language of the agreement establishing the trust.
 - (i) "Whether a beneficiary is entitled to support from the trust if other resources are available is a question of trust interpretation. *Smith v. Gillikin*, 201 Va. 149, 153-54, 109 S.E.2d 121, 124 (1959). *In reaching the correct interpretation, the intent of the testator in establishing the trust as ascertained from the plain language of the instrument controls a court's inquiry.* *Gasque v. Sitterding*, 208 Va. 206, 210-11, 156 S.E.2d 576, 580 (1967); *Smith*, 201 Va. at 154, 109 S.E.2d at 124; *Mills v. Embrey*, 166 Va. 383, 385, 186 S.E. 47, 48 (1936)." *NationsBank v. Grandy*, 248 Va. 557, 561, 450 S.E.2d 140 (1994) (emphasis added). In *Grandy*, the trustees under a testamentary trust with broad discretionary powers did not abuse their discretion by refusing to invade trust principal on behalf of an incapacitated beneficiary, and the Virginia Supreme Court reversed a trial court decision to the contrary, holding that the trial court impermissibly substituted its judgment for that of the trustees by compelling them to invade the trust principal.
 - (ii) The trust instrument should accordingly clarify that the testator intends that the trustee act in such a fashion as to preserve, insofar as is possible the Medicaid and applicable Social Security benefits of the beneficiary. A provision in the trust in which the trustee is required to make disbursements in a manner designed to avoid rendering the beneficiary ineligible for public assistance to which he might otherwise be entitled cannot be construed as a right possessed by the beneficiary to compel such payments for purposes of compelling disbursements for the beneficiary's support or reimbursement to Medicaid.⁴⁴
 - (iii) Assets in a discretionary, testamentary trust cannot be attributed to the beneficiary except to the extent the trustee makes the same available to

⁴⁴Va. Code § 55-545.03:1 C.

the beneficiary.⁴⁵

b. Creditor Protection for Discretionary Trust.

- (i) Except for claims of regarding the beneficiary's child support, *whether or not a trust contains a spendthrift provision*, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if the discretion is expressed in the form of a standard of distribution; or the trustee has abused the discretion.⁴⁶
- (ii) The Commonwealth of Virginia cannot assert a claim for reimbursement can be made under Virginia Code § 55-543.03:1 "if the beneficiary is an individual who has a medically determined physical or mental disability that substantially impairs his ability to provide for his care or custody and constitutes a substantial handicap," identify the beneficiary as a person with such a disability *in the will itself*.

c. Income Analysis For Distributions From Trust.

- (i) Cash distributions to the beneficiary will be deemed income to the beneficiary, reducing or eliminating SSI or Medicaid benefits to the beneficiary.⁴⁷
 - (ii) Loans from the trust to the beneficiary are not considered income under SSI⁴⁸ or Medicaid⁴⁹ rules.
 - (iii) Trust distributions of food, clothing, or shelter,⁵⁰ or to third parties which result in food, clothing, or shelter for the trust beneficiary are *not* counted as income by Medicaid.⁵¹
- d. When the testator is survived by a Medicaid recipient spouse, the survivor's elective share and augmented estate rights⁵² must be considered in making a testamentary trust for the benefit of a disabled child.⁵³

⁴⁵ Va. Medicaid Manual § M 1140.400

⁴⁶ Va. Code § 55-545.04. Even the child of the beneficiary may reach the trust only when the trustee has not complied with a stated standard of distribution or has abused a discretion provided for in the instrument. *Id.*, C.

⁴⁷ Va. Medicaid Manual, § M1120.200 (E)(1)(a).

⁴⁸ 20 C.F.R. 416.1103(f).

⁴⁹ Va. Medicaid Manual, § S0815.350.

⁵⁰ Va. Medicaid Manual § M0815.001 (B) ("*Contributions of in-kind items are not income.*") (emphasis in original).

⁵¹ Va. Medicaid Manual § M 1120.200 (E)(1)(c) provides that "[d]isbursements from the trust by the trustee to a third party that result in the individual receiving items that are not food, clothing or shelter are not income. For example, if trust funds are paid to a provider of medical services for care rendered to the individual, the disbursements are not income for Medicaid purposes."

⁵² See Va. Code Ann. § 64.1-13 et seq.

⁵³ Va. Medicaid Manual, § M1450.003 (C) second bullet, which defines an uncompensated transfer as including the failure to assert an inheritance right in court. Apart from conflicting with the Medicaid policy

- (i) Spouses are authorized by statute to enter into marital agreements.⁵⁴ These agreements may provide for the disposition of their estates at death.⁵⁵
- (ii) applicable law on the election of a share by the surviving (institutionalized) spouse should be consulted before pursuing this strategy. States considering this or related questions in the Medicaid context have reached different results, usually in the absence of a lifetime marital agreement.⁵⁶
- (iii) A testamentary trust by a husband of an institutionalized community spouse, who is also the father of a disabled child, could direct all or a portion⁵⁷ of the trust income to the community spouse, simultaneously

found in §M1120.010 (C)(2), which provides that Medicaid does not require litigation for access to property, the bulleted item begs the question of whether the survivor spouse's transfer of his or her right to a share to the decedent's estate, to the decedent spouse during lifetime eliminates the "right" in the estate at death, see below.

⁵⁴Va. Code Ann. § 20-155.

⁵⁵Va. Code Ann. § 20-150 (3,5). Such agreements do not require consideration apart from the marriage, Va. Code Ann. § 20-149. However, the agreement should contain a cross-waiver of the right to elective shares. This may avoid a DMAS argument that an agreement not to claim the elective share is an "uncompensated transfer." A waiver by each spouse to elect against the estate of the other appears to be legal consideration for the agreement. In any event, transfers (uncompensated or otherwise) between spouses do not subject either spouse to Medicaid ineligibility, see 42 U.S.C. § 1396p (c)(2)(B)(i).

⁵⁶See *Dionisio v. Westchester County Department of Social Services*, 1997 N.Y. App. Div. LEXIS 11585 (Sup.Ct. 1997) (institutionalized spouse's unilateral waiver of estate participation was transfer of assets; counsel failed to proffer copy of mutual waiver); *Nielsen v. Cass County Social Services Board*, 395 N.W.2d 157 (N.D. 1986) (Medicaid applicant's guardian permitted to disclaim inheritance without rendering ward ineligible); *Flynn v. Bates*, 413 N.Y.S.2d 446 (Sur. Ct. 1979) (Medicaid benefits properly denied when surviving spouse does not elect against will of deceased spouse). See also *Estate of Ott*, 408 N.Y.S.2d 303, 306 (Sur. Ct. 1978) (renunciation not a transfer at common law)(pre-OBRA).

If the spousal agreement is bilateral, with cross waivers supporting one another as consideration, there is no "uncompensated" transfer by either spouse of any asset to another. If the agreement is held to be an uncompensated transfer in any case, the transfer is of the elective share right between spouses. Inter-spousal transfers do not form the basis for any Medicaid disqualification. See 12 VAC 30-40-300 (E). Thus, with a post-nuptial waiver, the community spouse could bypass the surviving institutionalized spouse altogether, or establish a purely discretionary, spend-thrift testamentary trust to provide benefits to the disabled child and the surviving spouse which will not prevent either from receiving or retaining Medicaid benefits.

⁵⁷The extent to which trust income would be sufficient to equal one third of the estate's value will depend upon the age of the community spouse at the time of death. See life estate tables at Va. Medicaid Manual, §M1450.1000.

An actuarially unsound annuity will not necessarily be fatal to the surviving spouse's Medicaid entitlement in one and probably two cases. If the survivor spouse is not a Medicaid recipient or applicant when the first spouse dies, or within the penalty period determined under Va. Medicaid Manual, § M1450.701 (D), any possible penalty period will commence to run at the death of the first spouse. If this is expired by the time the survivor spouse applies for Medicaid there is no practical period of ineligibility. See Va. Medicaid Manual, § M1450.702 (B). Even if the income interest is insufficient to equal one-third of the value of the estate under Va. Code Ann. § 64.1-16.2 and or if the trust provides for the sole benefit of the survivor

providing for the survivor spouse's Medicaid qualification,⁵⁸ and providing for full discretion with respect to the disabled child distributions, with a remainder or sprinkle provision for other well children of the couple.

3. Settlor's Tax Implications for Complex Trust.

- a. Estate tax rules apply.
- b. Income tax rules.

- (i) Complex trusts (in which there is a discretionary standard of distribution) and which do not transfer all of their income to the beneficiary in the year are taxed upon the same.⁵⁹

4. Beneficiary's Tax Implications.

- a. Income tax.

- (i) Beneficiary is taxed on distributions actually made to or for the benefit of the beneficiary to the extent of distributable net income; the beneficiary is not taxed on corpus distributions.⁶⁰

B. Revocable Trust.

1. Settlor's Implications.

- a. Revocable trusts are "transparent" until distributions to anyone other than the applicant or recipient are made. Until such distributions are made, Medicaid treats the assets as available to the settlor or the settlor's spouse for purposes of determining Medicaid eligibility for either.⁶¹
- b. Distributions made to anyone other than the settlor or the settlor's spouse are treated as a transfer of assets by the settlor or the settlor's spouse.⁶²
- c. Because distributions from the trust are "considered assets disposed of by the individual for the purposes of [42 U.S.C. § 1396p (c)]," see 42 U.S.C. § 1396p (d)(3)(A)(iii), such distributions from the trust would be subject

spouse and the remainder to and for the sole benefit of the disabled child, since any transfer to either is fully exempted from disqualification analysis.

⁵⁸Virginia Code § 64.1-16.2 specifies that in "determining the elective share, values included in the augmented estate which pass ... to the surviving spouse, ... are applied first to satisfy the elective share ..."

⁵⁹IRC § 661, limited by § 663.

⁶⁰IRC § 661, 662.

⁶¹12 VAC 30-40-300(F); Va. Medicaid Manual § M 1450.550. "A transfer of assets into a revocable trust does not affect eligibility because the entire principal of a revocable trust is an available resource to the individual."

⁶²Va. Medicaid Manual § M 1450.550 B 2.

to the same exemptions as applicable to outright transfers by the grantor of the trust.

2. Beneficiary's Implications.

- a. See discussion relating to the beneficiary implications of the testamentary discretionary trust, *supra*.



3. Special Caveats For Married Settlor.

- a. **When the settlor is survived by a spouse who is or within five years of the death of the settlor spouse becomes a Medicaid applicant or recipient, in addition to the elective share issues noted in the treatment of the testamentary trust, the assets in the revocable trust, unlike those in a testamentary trust, are considered to have been transferred by the surviving spouse.**
- b. If the trust does not meet any transfer of asset exemption⁶³ the survivor spouse may be disqualified for Medicaid benefits based upon the "uncompensated value" of the assets transferred into the trust at the death of the settlor.
- c. If the revocable trust is for anything other than the "sole benefit" of the spouse and the disabled child (i.e., no remainder to anyone at the death of the child), then the revocable trust will not meet the transfer of asset exemption.⁶⁴

C. Irrevocable Inter Vivos Trust Created After August 10, 1993, With Assets Other Than Those Of The Beneficiary.⁶⁵

1. Settlor's Medicaid Implications.

a. Settlor Retains Interest In Trust.

- (i) When the trust allows for circumstances under which payment can be made to or for the benefit of the individual settlor / transferor from all

⁶³12 VAC 30-40-300(F); Va. Medicaid Manual, § M1450.300, 400.

⁶⁴12 VAC 30-40-300(F). See also Va. Medicaid Manual, § M1450.400 and HCFA Trans. 64 (11/94), which requires that the trust pay out for the actuarially determined life expectancy of the disabled child.

⁶⁵Trusts created prior to this date are governed by 12 VAC 30-40-300 (A) through (D).

or a portion of the trust, the portion of the trust which *could* be paid to or for the benefit of the settlor / transferor is a resource available to him.⁶⁶

(ii) Income produced by the trust principal which could be paid to or for the benefit of the individual is a resource available to him,⁶⁷ and payments which are actually made to the settlor / transferor are counted as income to him.⁶⁸

(iii) Payments from the trust which are not made to the settlor / transferor are viewed as uncompensated transfers of assets.⁶⁹

b. Settlor Retains No Interest In Trust.

(i) When a settlor / transferor transfers property to the trust which does not allow for payment to or for the settlor / transferor, the transfer is considered a transfer of assets for less than fair market value.⁷⁰

(ii) The look-back date for the transfer is sixty months from the date of the transfer, or the last transfer by the settlor / transferor into the trust.⁷¹

(iii) If the transfer is for the sole benefit of a child under the age of twenty one years, a disabled child of the settlor / transferor, a disabled person under the age of sixty five years (if the state is permitted recovery under the provisions of 42 USC 1396p(d)(4)(A),⁷² or the spouse of the settlor / transferor, the settlor / transferor's transfer *into* the trust will have no effect on Medicaid eligibility on the settlor / transferor.⁷³

(iv) Transfers by the trustee from such a trust do not affect the Medicaid eligibility status of the settlor / transferor.⁷⁴

2. Non-Settlor (Non-Self Settled) Beneficiary's Implications.

⁶⁶12 VAC 30-40-300(F); Va. Medicaid Manual § S 1120.201(C)(2)(b); Va. Medicaid Manual § M 1450.550 C. Thus, no period of ineligibility will be imposed for such a transfer, regardless of whether the trustee refuses to use the assets for the benefit of the settlor / transferor.

⁶⁷ Va. Medicaid Manual § M 1450.550 (C) (1) (2).

⁶⁸ Va. Medicaid Manual § M 1450.550 (C) (1) (4).

⁶⁹ Va. Medicaid Manual § M 1450.550 (C) (1) (3).

⁷⁰12 VAC 30-40-300(F). Va. Medicaid Manual, §M1450.550 (C) (2).

⁷¹ Va. Medicaid Manual, §M1450.550 (C) (2) (c).

⁷²See below.

⁷³12 VAC 30-40-300(F)(2); (G).

⁷⁴Va. Medicaid Manual, § M1450.550 (C)(2)(b).

- a. Grantor trust.
 - (i) An irrevocable trust in which the settlor retains sufficient controls will be deemed a grantor trust.
 - (ii) Grantor trust income will be taxed at the grantor's income tax rate (and be subject to the settlor's deductions, etc.).
- b. Non Grantor trust. See discussion relating to the beneficiary implications of the testamentary discretionary trust, *supra*.

III. Retained Power Of Appointment Trusts (RAPT).

- A. An irrevocable trust with a purely discretionary distribution standard in which the grantor retains no right to income or principal but over which he retains only:
 1. a power of appointment to direct the trustee to distribute funds to and among the named beneficiaries (likely the living issue and collaterals of issue at any time during the trust's existence);
 2. a power to reacquire the trust assets upon exchange of assets of like value; and
 3. a power to appoint and vary (but never beyond zero) the number and character of beneficiaries among any blood descendants of the great-grandparents of himself and his deceased spouse,⁷⁵ and never to include himself, his estate, or the creditors of himself or his estate

will constitute an uncompensated transfer of assets as of the date on which the transfer is made and create a grantor trust.

B. Medicaid.

1. When the trust is funded, the 60 month look-back clock starts.
2. Grantor in good health.
 - a. If sufficient income and resources exist outside of the trust to provide for the grantor's needs for at least 60 months, then the trust will have zero impact (and at least 60 months growth) when the look-back has been met.
 - b. Grantor enforces his wishes for gold and silver (or their avails, being apes, peacocks and ivory)⁷⁶ by judicious pruning and splicing of the beneficiary list, and thoughtfully fingering his will (by which he can exercise the power of appointment out of the Trust).
 - c. Payments made to the beneficiary will not be taxable income to the beneficiary from the trust.
 - d. Payments made by the beneficiary for the Grantor will require a gift tax return to the extent they exceed annual gift tax exclusion.⁷⁷

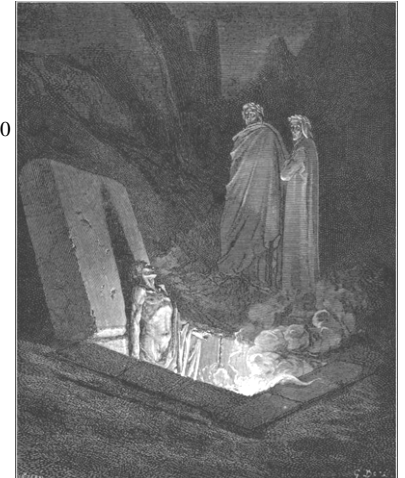


⁷⁵ Not recommended for currently married persons.

⁷⁶ At least in Tarshish County, *see* 1 Kings 22.

⁷⁷ IRC § 2503(b).

- e. Payments made by the beneficiary to the nursing home will constitute voluntary conveyances if the parent is not then in necessitous circumstances.
3. Grantor in poor health.
- a. If supplemental funds are needed for the grantor's long term care needs, the trustee can distribute the necessary supplement to a child who can then make a direct payment to the nursing home with the donated funds until the look-back period has been met.
 - b. Payments made to the beneficiary will not be taxable income to the beneficiary from the trust.
 - c. Payments made by the beneficiary directly to the nursing home will not require a gift tax return.⁷⁸
 - d. Payments made by the beneficiary to the nursing home will not constitute a voluntary or fraudulent conveyance because the child has a duty of support for the parent.⁷⁹
4. Taxes.
- a. Grantor trust income tax rules apply.
 - b. Property remains in taxable estate, thus assuring step-up.⁸⁰



IV. Beneficiary Settled Trusts Under 42 USC 1396p(d)(4)(A).

A. SSI Implications.

1. Federal Statute.

- a. 42 USC 1382b, *Resources*, specifies exempt resources for the SSI program.
- b. Uncompensated transfers of assets on and after January 1, 2000, within three years of application for SSI, can result in disqualification for up to three years.
- c. 42 USC 1382b (c) (1) (C) (ii) incorporates Medicaid exceptions to the period of disqualification for SSI (and thus categorical eligibility for Medicaid) for transfer of any asset to certain beneficiaries (spouses,

⁷⁸ IRC §2503(e).

⁷⁹ To the extent of his ability to do so, after supplying the needs of his more proximate family dependents, see the little cited Va. Code § 20-88.

⁸⁰ Image: Gustave Doré, *He, soon as there I stood at the tomb's foot ey'd me a space, then in disdainful mood address'd me*, from *The Vision of Hell*, by Dante, Canto X.

disabled children, etc.) and to the trusts described in this part of the outline:

“(C) An individual shall not be ineligible for benefits under this subchapter by reason of the application of this paragraph to a disposal of resources by the individual or the spouse of the individual, to the extent that -

....

the resources -

(I) were transferred to the transferor's spouse or to another for the sole benefit of the transferor's spouse;

(II) were transferred from the transferor's spouse to another for the sole benefit of the transferor's spouse;

(III) were transferred to, or to a trust (including a trust described in section 1396p(d)(4) of this title) established solely for the benefit of, the transferor's child who is blind or disabled; or

(IV) were transferred to a trust (including a trust described in section 1396p(d)(4) of this title) established solely for the benefit of an individual who has not attained 65 years of age and who is disabled.⁸¹

d. The Medicaid exceptions for trusts funded with the assets of the Medicaid applicant / recipient set forth in 42 USC 1396p (d) are also specifically incorporated for *SSI purposes* at 42 USC 1382b.

(i) 42 USC 1382b (e)(1) provides, “[i]n determining the resources of an individual, paragraph (3) shall apply to a trust (other than a trust described in paragraph (5)) established by the individual.)

(ii) 42 USC 1382b (e)(3) states:

“(A) In the case of a revocable trust established by an individual, the corpus of the trust shall be considered a resource available to the individual.

(B) In the case of an irrevocable trust established by an individual, if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual (or of the individual's spouse), the portion of the corpus from which payment to or for the benefit of the individual (or of the individual's spouse) could be made

⁸¹Emphasis added. The Federal POMS seems to expand the exception from disqualification to include the pooled asset trust for a disabled person of any age under 42 U.S.C. 1396p(d)(4)(C).

shall be considered a resource available to the individual.”

- e. 42 USC 1382b (e)(5) states that “[t]his subsection shall not apply to a trust described in subparagraph (A) or (C) of section 1396p(d)(4) of this title.”

2. Federal POMS.

- a. The Social Security Administration Program Operation Manual System (the POMS) is the statement of policy by which the Agency makes its determinations of eligibility.
- b. POMS SI 01120.203 (D), *Exceptions to Counting Trusts Established on or after 1/1/00*” provides the following “step” table:

STEP	ACTION
1	Was the trust established with the assets of an individual under age 65? (SI 01120.203B.1.b.) <ul style="list-style-type: none">• If yes, go to Step 2.• If no, go to Step 8.
2	Was the trust established with the assets of a disabled individual? (SI 011203B.1.c.) <ul style="list-style-type: none">• If yes, go to Step 3.• If no, go to Step 8.
3	Is the disabled individual beneficiary of the trust? (SI 01120.203B.1.d.) <ul style="list-style-type: none">• If yes, go to Step 4.• If no, go to Step 8.

4	<p>Did a parent, grandparent, legal guardian or a court establish the trust? (SI 01120.203B.1.e.)⁸²</p> <ul style="list-style-type: none"> • If yes, go to Step 5. • If no, go to Step 8.
5	<p>Does the trust provide specific language to reimburse the State for medical assistance paid upon the individual's death as required in SI 01120.203B.1.f.?</p> <ul style="list-style-type: none"> • If yes, go to Step 6. • If no, go to Step 8.
6	<p>The trust meets the special needs trust exception to the extent that the assets of the individual were put in trust prior to the individual attaining age 65. Any assets placed in the trust after the individual attained age 65 are not subject to this exception.</p> <p>Go to Step 7 for treatment of assets placed in trust prior to age 65.</p> <p>Go to Step 8 for treatment of assets placed in trust after attaining age 65.</p>

⁸² According to the cited policy, “[t]he person establishing the trust must have legal authority to act with regard to the assets of the individual. An attempt to establish a trust by an individual without the legal right or authority to act with respect to the assets of the individual may result in an invalid trust. NOTE: This requirement refers to the individual who physically took action to establish the trust even though the trust was established with the assets of the SSI claimant/recipient.” There is no federal basis for this rule, which occasionally led cautious lawyers to the unnecessary expense of contorted legal proceedings to appoint a designated settlor as limited guardian / conservator to obtain the “legal right or authority” to act on behalf of competent beneficiaries whose assets, often from personal injury recoveries, fund the trust. Fortunately, Social Security Administration Regional Chief Counsel, citing *Old Republic Nat. Title Ins. Co. v. Tyler (In re Dameron)*, 155 F.3d 718, 722 (4th Cir. 1998), has opined that when “an agreement satisfies 42 U.S.C. '1382b(e)(5), there will always be a corpus. It is irrelevant that a parent or grandparent sets up an agreement that has little or no funds, because ultimately the disabled individual for whom the trust is established will provide the assets. In addition, in these agreements, the disabled individual will be the settlor. 76 Am. Jur. 2d Trusts (1992) (stating that under general trust principles, the person who provides consideration for the trust is the settlor, even though in form the trust is created by another person). Further, the disabled individual will also be a beneficiary, as the trust is established for his/her benefit. Moreover, the essential purpose of the agreement will be to ensure that a trust established with the assets of the settlor is not counted as a resource for purposes of SSI and that the state Medicaid provider(s) is reimbursed. In short, when an agreement satisfies the requirements of 42 U.S.C. '1382b(e)(5), circumstances unequivocally show an intention that the legal estate be vested in one person, to be held in some manner or some purpose on behalf of another. Id. Therefore, Virginia courts will recognize agreements that satisfy 42 U.S.C. '1382b(e)(5) as valid trusts.” PS 01825.052 - Virginia - 01/29/2004 (<https://secure.ssa.gov/apps10/poms.nsf/lnx/1601825052!opendocument>).

7	<p>Is the trust irrevocable?</p> <ul style="list-style-type: none"> • If yes, assets placed in the trust prior to age 65 are not a countable resource. STOP. • If no, evaluate the trust under SI 01120.200 to determine if it is a countable resource.
8	<p>The trust (or portion thereof) does not meet the requirements for the special-needs trust exception.</p> <p>Determine whether the pooled trust exception in SI 01120.203B.2, applies.</p>

B. Medicaid Implications.

While Congress obviously limited the use of trusts to qualify or retain eligibility for Medicaid in 1993, it simultaneously incorporated into statutory law the judicial gloss that had developed to help disabled Medicaid beneficiaries.⁸³

Two of the OBRA'93 trusts are important in Virginia practice.⁸⁴

1. Individual Trusts For Disabled Persons Under Age 65.⁸⁵

- a. These trusts are not deemed to be a resource of the beneficiary.⁸⁶
- b. The only persons who may establish these trusts are the disabled person's parent, grandparent, or legal guardian, or a court on behalf of the disabled person.⁸⁷

⁸³42 USC 1396p(d),(e); 12 VAC 30-40-300 (E)(1), effectively eliminating by statute and regulation the pre-OBRA law basis for these trusts, see *Miller v. Ibarra*, 746 F.Supp. 19 (D.Colo. 1990); *Navarro v. Sullivan*, 751 F. Supp 349 (E.D.N.Y. 1990); *Trust Company of Oklahoma v. State of Oklahoma*, 825 P.2d 1295 (Ok. Sup. Ct. 1991), cert den., 121 S.E.2d 224 (1992) (court established trust); *Kegel v. State*, 830 P.2d 563 (N.M. App. 1992); *Hughes v. Physicians Hospital*, 566 N.Y.S.2d 496 (Sup. 1991) (settlement paid directly to special needs trust without intervention of guardian, under court order).

⁸⁴The third trust is for use in "income-cap" states, which include the State of Florida. Income-cap states do not cover the optional medically needy category. Such states impose a strict limit on income as a condition to Medicaid eligibility. The unavailability of Medicaid in these states was the original basis for *Miller v. Ibarra*, 746 F.Supp. 19 (D.Colo. 1990), the seminal special needs trust case. When the settlor / transferor is likely to reside in an income cap state, counsel should review 42 U.S.C. § 1396p (d) (4)(B) for the specific requirements for these "income" trusts and consult local counsel for drafting nuances of the particular jurisdiction.

⁸⁵42 U.S.C. § 1396p (d)(4)(A); 12 VAC 30-40-300(F)(3)(g)(1); *Medicaid Manual*, M1120.202.

⁸⁶42 U.S.C. § 1396p (d)(4)(A); 12 VAC 30-40-300 (E)(3)(g); Va. Medicaid Manual, § M1120.202(B).

- c. Transfers to such a trust are not considered disqualifying transfers of assets.⁸⁸
- d. The trust must be for the sole benefit of an individual under 65 who is disabled for Social Security purposes (i.e., "disabled as defined in [42 U.S.C. § 1382c(a)(3)]").
- e. The trust must provide that the state will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the beneficiary under a the Medicaid plan.
 - (i) Since it is impossible to predict how Medicaid may mutate or whether it will even survive, payment should be qualified by language limiting the requirement to the minimum necessary to secure the exemption.
 - (ii) If the reimbursement requirement is later eliminated, a naked direction to reimburse could require trust assets to be paid the state that otherwise could have passed to the settlor's more likely remainder persons.
- f. Section 3259.7 of HCFA Trans. 64 (11/94) states that the trust exemption continues even after the beneficiary reaches age 65. However, HCFA then states that the trust "cannot be added to or otherwise augmented after the individual reaches age 65. Any such addition ... after age 65 involves assets that were not the assets of an individual under age 65. Thus those assets are not be [sic] subject to the exemption discussed in this section."⁸⁹
- g. Grantor / Beneficiary Income Tax Implications.

To preserve the grantor trust tax status of the income generated on the trust (i.e., to have the income taxed at the same rate as the disabled beneficiary), one or more administrative incidents of control over the trust should probably be retained.⁹⁰

⁸⁷42 U.S.C. § 1396p (d)(4)(A); 12 VAC 30-40-300 (F)(2)(c)(2)(d); Va. Medicaid Manual, § M1120.202(B).

⁸⁸42 U.S.C. § 1396p (c)(2)(B)(iv); 12 VAC 30-40-300 (E)(3)(g); Va. Medicaid Manual, § M1450.502 (C).

⁸⁹ Accord: POMS SI 01120.203, *Exceptions to Counting Trusts Established on or after 1/1/00*, (B)(1)(b). The cited HCFA policy also requires that when the trust beneficiary has resided in more than one state, the states in which he has resided shall receive a proportionate reimbursement share upon the beneficiary's death. The Virginia Medicaid Manual states *under its reference to pooled trusts* that "[a] trust established for a disabled individual under age 65 years is exempt from the transfer of assets provisions. However, any funds placed in the trust after the individual turns 65 must be evaluated as an asset transfer." Va. Medicaid Manual § M 1450.550 (D).

⁹⁰For tax purposes, the grantor of the trust can be the transferor of funds *into* the trust, even though another person is the nominal settlor of the trust. *Blackman v. United States*, 30 A.F.T.R. 846 (Ct. Cl. 1943); Priv.

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h. Grantor / Beneficiary Gift and Estate Tax Implications.

To preserve a step-up for the remainder-persons as to any residue in the trust which is not paid to the state to reimburse the Medicaid claim, in the beneficiary (and considerably more flexibility in the disposition of the assets at the death of the beneficiary), a special power of appointment may be reserved to the beneficiary.⁹¹

2. Non-Profit Pooled Trust For Disabled Persons Of Any Age.

The second trust available in Virginia practice is the nonprofit pooled trust for disabled persons of any age.⁹² Assets in pooled trust are not available resources to the beneficiary of the trust or to the grantor of the trust, but may trigger Medicaid and SSI penalties for the person transferring assets to the trustee if the beneficiary is 65 or older.

a. Transfers are exempt from penalty for the transferor when the trust beneficiary has not yet attained the age of 65.

(i) For Virginia Medicaid purposes, see Va. Medicaid Manual § M1450.550 (D).⁹³

Ltr. Rul. 90--4-007.

While IRC § 674 provides grantor tax status to a trust when the grantor (here, the beneficiary) retains the unrestricted right to remove, substitute, or add trustees, and to designate any person, including the beneficiary/grantor as the replacement, see Treas.Reg. §1.674(d)-2, this power could easily be deemed to require the beneficiary to appoint the property to himself, thus destroying the exempt status of the trust for Medicaid purposes. A better retained power is found by reference to IRC §675(4), which taxes the grantor on the trust income if the grantor retains possession of a power to reacquire the trust property by substituting property of equal value for the same. See also Rev. Rul. 83-25, 1983-C.B. 116; Priv. Ltr. Ruls. 95-02-019, 95-02-020, 95-02-024, 95-02-029, and 95-02-031.

⁹¹Treas.Reg. §25.2511-2(c); Priv. Ltr. Rul. 94-37-034. Note that it is not relevant that the beneficiary is actually incapable of exercising the retained power of appointment, *Boeving v. United States*, 493 F.Supp. 665 (D. Mo. 1980), *rev'd*, 650 F.2d 493 (8th Cir. 1981), the mere existence of the retained power of appointment appears to avoid any completed gift for this purpose. *Estate of Alperstein v. Commissioner of IRS*, 613 F.2d 1213 (2d Cir. 1979); Rev. Rul. 55-518, 1955 12 C.B. 384; the

⁹²For Medicaid, see 42 U.S.C. § 1396p (d)(4)(C); 12 VAC 30-40-300(F)(3)(g)(2); *Medicaid Manual*, M1120.202. For SSI, see SI 01120.203 (B)(2), *Exceptions to Counting Trusts Established on or after 1/1/00* ("There is no age restriction under this exception. However, a transfer of resources to a trust for an individual age 65 or over may result in a transfer penalty (see [SI 01150.121](#)). **CAUTION:** A trust which meets the exception to counting the trust under the SSI statutory trust provisions of 1613(e) must still be evaluated under the instructions in [SI 01120.200](#) to determine if it is a countable resource.").

⁹³"A pooled trust is a trust that can be established for a disabled individual under the authority of Section 1917(d)(4)(C) of the Social Security Act (see [M1120.202](#)). The placement of an individual's funds into a pooled trust when the individual is age 65 years or older must be evaluated as an uncompensated transfer, if the trust is structured such that the individual irrevocably gives up ownership of funds placed in the trusts. *A trust established for a disabled individual under age 65 years is exempt from the transfer of assets provisions. However, any funds placed in the trust after the individual turns 65 must be evaluated as an asset transfer.*"

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(ii) For SSI purposes, see SI 01150.121 (A)(3), *Exceptions — Transfers to a Trust*.⁹⁴

- b. Only nonprofit associations may establish and manage these trusts. The disabled beneficiary's parent, grandparent, legal guardian, court, or the disabled person himself may establish an account in such trust.
- c. Separate accounts must be maintained for each beneficiary, but the trust may pool the funds for investment and management purposes. All accounts in the trust must be for the sole benefit of individuals who are disabled for Social Security purposes. The *Medicaid Manual* also requires the individual to have "been found to be disabled" by Social Security.
- d. The trust must allow Medicaid to recoup its expenditures when the beneficiary dies, but only to the extent that the residue is not retained by the trust. The donor into the trust (including the Medicaid recipient) can direct the residue of the sub-account be retained by the non-profit association instead of distributing the balance to Medicaid at the beneficiary's death.⁹⁵



⁹⁴ "The period of ineligibility does not apply to an individual who transfers a resource to a trust established for the sole benefit of an individual including himself or herself who is under age 65 and is blind or disabled. This includes trusts qualifying as 'Medicaid trust exceptions' in SI 01120.200 ff. (i.e., trusts established under Section 1917(d)(4)(A) and (C) of the Social Security Act)."

⁹⁵The right to direct the residue can provide strong incentives to caring for the disabled beneficiary, who (or whose guardian, child, spouse, etc.) could be provided a power to appoint and apportion the residue between Medicaid and the non-profit sponsor. Image: Gustave Doré, *The Saintry Throng in the Form of a Rose*, from *The Divine Comedy*, by Dante, Canto XXXI ("In fashion, as a snow-white rose, lay then Before my view the saintly multitude, Which in His own blood Christ espous'd.")

Appendix 1

	Violates Income Rules ⁹⁶	Does Not Violate Income Rules
Supplemental Security Income SSI	<p>Money given directly to beneficiary. Groceries Gas, electric, water bills Rent/Mortgage Property Taxes or Homeowner's insurance when beneficiary is owner</p> <p><i>Exception: food and rent/mortgage, etc. may be supplied if a 1/3 reduction in the SSI grant is accepted each month these are supplied.</i></p>	<p>Cable, phone clothing Travel expenses Personal care Maintenance of house owned by beneficiary Food for special occasions <i>like restaurant meals or contributions to holiday feasts</i> Specialized or adaptive equipment <i>including special clothing</i></p>
Medicaid	<p>Money given directly to beneficiary.</p> <p><i>This is the only limitation imposed by Medicaid rules</i></p>	<p>Same as above, and also: Groceries Clothing Rent/Mortgage/Insurance/Taxes</p>
Social Security (SSA) Social Security Disability (SSD, SSDI)	No Limitation	
Medicare	No Limitation	

⁹⁶ Acknowledgement of chart, with gratitude, to www.proguard.org.