

PLANNING FOR YOUR FUTURE

What's in a name?

By Bernard A. Krooks, Certified Elder Law Attorney

Special needs trusts generally fall into one of two categories, and the treatment and effect of any given trust varies depending on which kind of trust is involved. This has led to a tremendous amount of confusion and, in some cases, a significant loss of assets. Many (but not all) practitioners use the same language to describe the distinction: a special needs trust is either a “self-settled” or a “third-party” trust.

Why is the distinction important? Because the rules surrounding the two kinds of trusts are very different. For example, a “self-settled” special needs trust:

- Must include a provision repaying the state Medicaid agency for the cost of Medicaid benefits received by the beneficiary upon the death of the beneficiary.
- May have significant limitations on the kinds of payments the trustee can make; these limitations may vary significantly from county to county.
- Must be for the sole benefit of the person with disabilities during his lifetime.
- Will require an annual accounting to the state Medicaid agency of trust expenditures.
- May, if the rules are not followed precisely, result in the beneficiary being deemed to have access to trust assets and/or income, and thereby cost the beneficiary his Supplemental Security Income (SSI) and Medicaid eligibility.
- Will be taxed as if its contents still belonged to the beneficiary — in other words, as what the tax law calls a “grantor” trust.

By contrast, a “third-party” special needs trust:

- May pay for food and shelter for the beneficiary — though such expenditures may result in a reduction in the beneficiary's SSI for one or more months.
- Can be distributed to other family members, or even charities, upon the death of the primary beneficiary.
- May be terminated if the beneficiary improves and no longer requires SSI or Medicaid eligibility — with the remaining balance being distributed to the beneficiary.
- Will not have to account (or at least not have to account so closely) to the state Medicaid agency in order to keep the beneficiary eligible.
- Will be taxed on its own, and at a higher rate than a self-settled trust — though sometimes it will be taxed to the original grantor, and sometimes it will be entitled to slightly favorable treatment as a “Qualified Disability” trust.

So what is the difference? It is actually easy to distinguish the two kinds of trusts, though even the names can make it seem more complicated. A self-settled trust is established with money or property that once belonged to the beneficiary with disabilities. That might include a personal injury settlement, an inheritance, or just accumulated wealth. If the beneficiary had the legal right to the unrestrained use of the money — directly or through a guardian — then the trust is probably a self-settled trust.

Conversely, if the money belonged to someone else, and that person established the trust for the benefit of the person with a disability, then the trust will be a third-party trust. Of course, it also has to qualify as a special needs trust; not all third-party trusts include language that is sufficient to gain such treatment.



So, an inheritance might be a third-party special needs trust — if the person leaving the inheritance set it up in an appropriate manner. If not, and the inheritance was left outright to the beneficiary, then the trust set up by a court, guardian or family member will probably be a self-settled trust.

That leads to an important point: if the trust is established by a court, by a guardian, or even by the defendant in a personal injury action, it is still a self-settled trust for SSI and Medicaid purposes. Each of those entities is acting on behalf of the beneficiary, and so their actions are interpreted as if the beneficiary himself established the trust.

To make matters even more confusing, some lawyers call self-settled trusts, special needs trusts, while third party trusts are called supplemental needs trusts. Unfortunately, the legal guidelines and practices do not require that lawyers use these names so it may depend on your lawyer.

Although we are sorry about the confusion, we strongly suggest that when reading about special needs trusts on the internet or in other literature, that you make sure you know which kind of trust is being described and discussed. This way, you can make sure you're getting the right information.

Bernard A. Krooks, J.D., CPA, LL.M. (in taxation), CELA, AEP® is a founding partner of the law firm Littman Krooks LLP with offices in Fishkill, White Plains, and New York City. Mr. Krooks is past President of the National Academy of Elder Law Attorneys (NAELA), past President, and a founding member, of the NY NAELA Chapter, and is past Chair of the Elder Law Section of the New York State Bar Association. He is immediate past President of the Special Needs Alliance (www.specialneedsalliance.org), a national not-for-profit organization dedicated to assisting families with special needs planning. Mr. Krooks is currently President of the Estate Planning Council of Westchester. Mr. Krooks may be reached at (845) 896-1106, or visit the firm's website at www.littmankrooks.com.