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staff for the Judiciary B Committee
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TRUSTS FOR INDIVIDUALS RECEIVING GOVERNMENT ASSISTANCE - BACKGROUND MEMORANDUM

Senate Bill No. 2187 (attached as Appendix A) directs a study of trusts for individuals with disabilities. The bill as introduced would have provided statutory authority for the creation of special needs and supplemental needs trusts. The bill was amended in the Senate to provide for technical changes. Then, in the House, the substance of the bill was replaced by a study directive. A copy of the bill as engrossed in the Senate is attached as Appendix B.

LEGISLATIVE HISTORY

Engrossed Senate Bill No. 2187 contained the general rule for counting trust assets as assets for Medicaid eligibility purposes--a trust that provides for the lessening of trust benefits if the beneficiary applies for, is determined eligible for, or receives public assistance is unenforceable as against the public policy of this state unless the trust is a special needs or supplemental needs trust. The bill would have defined an individual with a disability, a special needs trust, and a supplemental needs trust. The bill defined a "special needs trust" as a trust allowed by federal law which allows an individual with a disability to have created a trust using that individual's assets for special needs while receiving medical assistance. The bill defined a "supplemental needs trust" as a trust created for the benefit of an individual with a disability by another that is not otherwise obligated to pay for the needs of that individual. The bill provided for requirements of supplemental needs trusts. For example, a supplemental needs trust must supplement or be complementary, i.e., not supplant medical assistance or other publicly funded benefit programs. In addition, the bill allowed a court to reform a trust to conform with state or federal law if necessary to accomplish the purpose of a supplemental needs trust or special needs trust.

Many trust practitioners use the terms "special needs trust" and "supplemental needs trust" interchangeably and duplicatively. For the purposes of this memorandum, the terms will be used as defined in Engrossed Senate Bill No. 2187. No matter what term is used, the difference between the two trusts depends upon who funds the trust. As defined above, a "special needs trust" is self-funded and a "supplemental needs trust" is funded by a third party. In addition, the terms "medical assistance" and "Medicaid" are interchangeable throughout this memorandum.

The legislative history reveals one of the reasons the substantive bill was turned into a study was because the committee understood that special needs and supplemental needs trusts could be created under present law, and the problem was with the education of attorneys. Another reason was that the clause relating to court reformation was contentious. The argument against the clause was that attorneys should draft the trust clearly, not allow courts to rewrite trusts.

SPECIAL NEEDS TRUST

A special needs trust is an exception to Medicaid and supplemental security income trust rules. Those rules ordinarily invade trust principal and income without regard to the purpose for which the trust was established. A special needs trust is specifically allowed under federal law.

Under 42 U.S.C. § 1396p(d)(4)(A), a special needs trust is:

> A trust containing the assets of an individual under age 65 who is disabled . . . and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual or court if the State will receive all amounts remaining in the trust upon the death of such individual up to any amount equal to the total medical assistance paid on behalf of the individual under a State plan under this subchapter.

As to provide a context for the focus of this memorandum, Medicaid trusts, the following is a short review of government programs with a focus on Medicaid. The principal health care programs are Medicaid and Medicare, and the principal income support programs are supplemental security income and Social Security disability income. Medicaid is a joint federal and state program that pays for medical care for individuals who cannot pay for their own medical bills. An individual must have limited income and few assets to qualify for Medicaid. Medicaid rules are complicated and different from state to state. Each state operates its own Medicaid program consistent with federal law. To be eligible for Medicaid, a person must meet income and asset eligibility guidelines. In North Dakota, an adult individual cannot have over $3,000 and a married person cannot have over $6,000 in available assets under the Medicaid eligibility rules. However, beginning on January 1, 2002, the children and family eligibility group for Medicaid will have no asset test. On the other hand, Medicare is a health insurance program based solely upon status, mainly age or disability.

Under North Dakota Administrative Code (NDAC) Section 75-02-02.1-25, assets include all assets

"actually available." "Actually available" means an applicant, recipient, or responsible relative having the power to dispose of an asset, having a legal interest in a liquidated sum and having the legal ability to make the sum available, or having the power to make or cause an asset to become available. A responsible relative is a spouse or a parent of a child under age 21 or if blind or disabled, under age 18. All assets of a responsible relative are deemed available to the applicant or recipient, even those assets that are not actually contributed to the applicant or recipient. If the child proves the child is living independently or is living with a parent who is separated from the child's other parent and that parent will not furnish information on that parent's assets, then the appropriate parental assets are not available.

Under NDAC Section 75-02-02.1-27, certain assets are exempt from consideration. These assets include a home, personal effects, and one motor vehicle. Under NDAC Section 75-02-02.1-28, certain assets are excluded from consideration. These include certain property that would create a hardship if sold, pre-need funeral service contracts, home replacement funds, and certain government payments, including unspent financial assistance for education.

Under NDAC Section 75-02-02.1-31, certain trusts are considered as assets. Assets in a revocable trust are available to the grantor. Generally, a revocable trust gives the power to remove property from the trust or end the trust to the grantor. Assets in a Medicaid-qualifying trust are available to the grantor. A Medicaid-qualifying trust is a trust that is not made in a will by an individual or the individual's spouse under which the individual may be a beneficiary of payments, and distribution of the payments is determined by one or more trustees who are permitted to exercise discretion as to the distribution to the individual. A Medicaid-qualifying trust is a trust deemed to be created to qualify for Medicaid benefits. Assets in a support trust are available to the beneficiary. A support trust has the purpose of providing for the care, support, or maintenance of the beneficiary.

According to Stuart E. Schmitz and Jeffrey W. Schmidt in a document entitled *Special Needs Trusts*:

> Social Security benefits are available as a retirement benefit at age 62 or 65 for individuals who have contributed to the Social Security system during enough calendar quarters of their working careers. This insurance-type benefit is also available to individuals who become disabled before reaching age 65. This is often referred to as Social Security disability or RSDI or SSDI. Whatever the name, it is unaffected by the assets, income or resources of the recipient. It is also unaffected by the creation of a special needs trust.
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> Supplemental Security Income benefits are based on financial need. The assets, income and resources of an applicant are closely reviewed to determine eligibility. The creation of a special needs trust can have a dramatic impact on eligibility.
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> [Supplemental Security Income], like Medical Assistance, is available to aged (over 65), blind or disabled individuals who meet certain financial criteria. *See generally* 42 U.S.C. §§ 1381, etc. Most income is countable and will prevent or reduce available [Supplemental Security Income] benefits. Assets are limited to $2,000 for an individual or $3,000 for a married couple. The house, primary vehicle and household and personal items are excluded from consideration. The assets of the individual's parent or spouse who is eligible for [Supplemental Security Income] will be deemed as available to the applicant.

One purpose of a special needs trust is to assure disabled individuals have money to be available to provide opportunities not covered by government programs. Special needs trusts allow individuals to shelter funds from governmental assistance entities while maintaining eligibility for government assistance, including Medicaid and supplemental security income.

Another purpose of a special needs trust, besides sheltering financial resources, is to provide extra benefits that are secondary to public or governmental resources. The trustee of a special needs trust has full discretion to provide extra benefits above the primary support funded by government assistance from both income and corpus of the trust. Many items are not covered by government assistance. These items include education, recreation, transportation, dental work, some medical work, and a variety of luxury items.

Again, a special needs trust is not an asset for determining eligibility for Medicaid; however, certain rules must be followed in creating the trust. A special needs trust may be funded solely with the assets of the disabled trust beneficiary. This could include the benefits under the terms of a settlement agreement or judgment, workers' compensation, inheritance, or life savings. However, the disabled trust beneficiary may not set up the trust for that beneficiary. Someone else must create the trust with the assets of the beneficiary. The creator may be a parent, grandparent, guardian, conservator, guardian ad litem, or court.

Although the disabled person has special needs trust funds available during that person's life to supplement publicly funded benefits, the trust beneficiary will be limited in that individual's choice of providers of medical services to those medical providers that are

medical assistance-certified. The beneficiary cannot reimburse nonmedical assistance providers from the trust when similar care is available with a medical assistance provider. In addition, at the death of the beneficiary, the trustee must repay the state for medical assistance benefits paid on behalf of that person during that person's life.

In drafting a special needs trust it is important to state:

1. The trust is for the sole benefit of the disabled beneficiary.
2. The authority of the settlor to establish the trust.
3. The trustee makes payments to providers of goods and services on behalf of the beneficiary. A special needs trust must be drafted so that payments are not made directly to the beneficiary.
4. The beneficiary's age, disability, and a written diagnosis from a licensed professional as to the disability.
5. Medical assistance benefits are reimbursed at the death of the trust beneficiary.
6. A supplemental purpose. The statement of supplemental purpose specifically states that the trust is intended to supplement rather than supplant government benefits, and that the trustee cannot operate the trust in such a manner.
7. The trust is irrevocable. The mere suggestion that the trust is revocable will eliminate the trust beneficiary from medical assistance or supplemental security income eligibility.

In addition to special needs trusts as the trusts have been discussed so far in this memorandum, there are special needs trusts funded by pooled assets. A pooled asset special needs trusts consists of multiple trust accounts that are pooled for investment and administration purposes. A nonprofit association must perform these duties. The nonprofit association pools the funds of many beneficiaries but is required to keep separate accounts for each beneficiary. The benefit to the beneficiary over a regular special needs trust is the use of professional services that might otherwise be cost-prohibitive.

SUPPLEMENTAL NEEDS TRUST

Supplemental needs trusts are trusts created using funds other than those belonging to the disabled individual, the individual's spouse, or someone legally responsible for the support of the disabled individual. Usually a family member such as a parent or grandparent will want to provide for the needs of a disabled child or grandchild; however, the family member will not want to make the disabled individual ineligible to receive governmental assistance.

A number of North Dakota Supreme Court cases have dealt with the issue of supplemental trusts. The main issue is whether the trustee is required in any manner to distribute funds from the trust to the disabled individual. In short, the trustee must have sole discretion over the trust, and the trust must be worded so as to be for the supplemental needs of the disabled individual.

In *Hecker v. Stark County Social Service Board*, 527 N.W.2d 226 (N.D. 1994), the court recognized supplemental needs trusts as legitimate. Herman Hecker, a single, developmentally disabled 44-year-old, applied to the Stark County Social Services Board for medical assistance through the state-administered Medicaid program. The board denied his application because of a trust created by his mother and valued at approximately $81,000 being included as Herman's asset. Herman appealed to the Department of Human Services, and the department upheld the board's decision finding that the trust was a support trust and hence available to Herman as a means of support. Herman appealed to district court which affirmed the department. The North Dakota Supreme Court reversed and remanded.

The trust stated it was a "supplemental fund to public assistance" to provide for Herman as if the parent was "personally present." The trustee was given "sole discretion" to use principal or income to pay for the "beneficiary's special needs." Special needs were defined as requisites for "good health, safety, and welfare when, in the sole discretion of the Trustee, such requisites are not deemed provided by any public agency, office, or department of the State of North Dakota, or of any other state, or of the United States." Special needs were defined to include medical and dental expenses, clothing and equipment, programs of training, education, treatment, and essential dietary needs to the extent that the needs were not provided by any governmental entity.

The main issue was whether the trust was a support trust or a discretionary trust. A support trust is a trust that provides that the trustee must pay income or principal as either is necessary for the education or support of a beneficiary. On the other hand, a discretionary trust is one that grants a trustee uncontrolled discretion over payments to the beneficiary. The trustee has the power to not make any distribution at all to the beneficiary, and the beneficiary cannot compel the trustee to make distributions under the terms of the trust instrument. If the trust was a support trust, it would be an available asset for determining Medicaid eligibility, but if the trust was discretionary, the trust is not an asset for determining Medicaid eligibility.

The department contended NDAC Section 75-02-02.1-31(3) negates the plain language of the trust. The regulation as adopted by the department

states that "a support trust" includes "trust" which may also be called "discretionary support trust" or "discretionary trust," so long as support is a trust purpose. The court held this section void because it overruled judicial precedent and exceeded the rulemaking authority of the department. The court held the section void because it supersedes the case law holding that the settlor's intent determines whether a trust is a support or a discretionary trust and there was no explicit legislative directive to create the rule.

Because the trust referred twice to the sole discretion of the trustee, unequivocally stated that it was meant to be a supplemental fund to public assistance, and plainly indicated an intent not to provide primary support or maintenance for the beneficiary, the court found the trust to not be an asset for determining Medicaid eligibility.

Under *Kryzsko v. Ramsey County Social Services*, 6000 N.W.2d 237 (N.D. 2000), a trust for a mentally disabled individual established in the will of a deceased parent was found to be a support trust instead of a supplementary trust. Under NDAC 75-02-02.1-31(3) and (4), a support trust is available to the applicant and considered in the applicant's assets, whereas discretionary trusts are only available to the extent amounts are actually distributed to the beneficiary. While certain assets are exempt from consideration, trusts available to the applicant are counted as assets.

The Kryzsko trust provided the trustee may use trust funds in the trustee's sole discretion to provide for the proper care, maintenance, support, and education of the beneficiary, and the trustee must make at least an annual distribution or more as the trustee deems in the trustee's sole discretion. The court found the language in the Kryzsko trust different than the Hecker trust because the court found the trustee in the Kryzsko trust did not have uncontrolled and absolute discretion to determine distributions. The court found the settlor had placed a duty on the trustee to provide a "proper" amount of care, maintenance, support, and education. The court said the word "proper" is an enforceable standard against which the reasonableness of the trustee's exercise of discretion may be judged. The court said even though the Kryzsko trust contained elements of both a discretionary and support trust, because there was some standard imposing some level of support, it was an asset to be considered in eligibility for Medicaid. The court also emphasized the trust did not suggest the trust was intended to be supplementary to other sources of care such as public assistance programs.

In *Eckes v. Richland County Social Services*, 621 N.W.2d 851 (N.D. 2001), Hillestad was disqualified from Medicaid benefits because she was the beneficiary of a residuary trust. The Department of Human Services held the trust assets were available for the purposes of determining eligibility for Medicaid. The district court upheld the department's decision and the Supreme Court reversed and remanded.

The department argued the language of the trust demonstrates the intent to create a support trust providing for "suitable support, care, necessities, and medical attention." In addition, the trust stated:

> It is my express direction that the principal of this trust not be invaded for the above-mentioned purposes until my said wife shall have exhausted all property held by her. I have purposely avoided making gifts of my property to my children during my lifetime to assure that the income of this trust be as large as possible. Therefore, in the event my said wife shall have made substantial gifts of her property to her children during her lifetime then I direct that no part of the principal of this trust be invaded for her benefit.

The will gave the remaining principal and any undistributed income in the trust, upon the death of Hillestad, to her late husband's children.

The court held the settlor intended the trust income as a support trust, which is available as an asset for the purposes of eligibility for Medicaid benefits. However, the court also held the settlor intended the principal of the trust as a hybrid trust with elements of both a support and discretionary trust, which was not available to the beneficiary as an asset if certain conditions were met. These conditions included exhausting all property held by the beneficiary and making substantial gifts of her property to her children during her lifetime. The court assumed Hillestad had exhausted all her property because of certain facts. The court held:

> . . . that Hillestad's late husband unambiguously created a support trust for Hillestad from the trust income, but the principal was a hybrid which could not be invaded because Hillestad made substantial gifts to her children during her lifetime. The Department's find that Hillestad's gifts to her children were not substantial relative to the property she owned at the time she made the gifts is contradicted by the plain language of the trust instrument which indicated the settlor's intent was to protect the trust principal for his own children unless Hillestad complied with his conditions. Based on the intent of Hillestad's late husband, the Department's definition of the term "substantial" is rejected, as a matter of law. The Department's decision that the trust principal could be invaded and was available for the purpose of Medicaid eligibility is not supported by a preponderance of the evidence.

A properly drafted supplemental needs trust will not affect eligibility for programs with an asset test. These programs include Medicaid, supplemental security income, and temporary assistance to needy families. There are other programs for which there is no asset test. These programs include the food stamp program and the children's health insurance program. Although a properly drafted supplemental needs trust will not have an asset issue with any of these programs, there are still income eligibility issues for each of these programs that need to be properly addressed in the trust instrument.

OTHER STATES

Minnesota has a statute much like the bill considered during the last legislative session. Minnesota Statutes Section 501B.89 provides exceptions to the general rule that a trust that provides for the limitation of the interest of a beneficiary if the beneficiary applies for or receives public assistance is unenforceable against the public policy of the state of Minnesota. There are two exceptions in the Minnesota statute which are almost identical to the exceptions in Engrossed Senate Bill No. 2187. The Minnesota law was enacted in 1992. Because the law has been in effect for nine years, there is ample literature on the application of the statute. If the committee wants to draft legislation, the committee may consider using the Minnesota statute as a template.

SUGGESTED STUDY APPROACH

Enacting a statute such as that proposed by Engrossed Senate Bill No. 2187 or the Minnesota statute is not required to create special needs trusts or supplemental needs trusts. These trusts are being used in this state. Enacting such a statute, however, would provide for legislative approval of these trusts by providing requirements, that if met, would provide for a trust not open to different interpretations. Because a special needs trust is allowed by federal law, no particular state action is necessary. Because a supplemental needs trust is provided for by state law, at this point through judicial decision, the committee may want to set the policy for these kinds of trusts.

The first decision of the committee should be whether to continue to have supplemental needs trusts. If the answer is yes, then the possible solutions for the committee are to keep the status quo, draft a bill that contains specific requirements, or draft a bill that requires the Department of Human Services to adopt rules that provide forms for acceptable supplemental needs trusts. To make this determination, the committee may want to receive testimony from interested parties to determine whether information on these trusts is readily available to attorneys and the residents of this state or whether there is discord between attorneys and the department in interpreting the proper requirements for a supplemental needs trust. If the availability of these trusts is unknown to attorneys or the public, if how to draft these trusts is unclear to attorneys, or if there is discord between attorneys and the department, the committee may want to take legislative action. Interested parties include the Department of Human Services, county social services agencies, attorneys, investment professionals, and individuals interested in creating supplemental needs and special needs trusts, including professional guardians.

ATTACH:2