WHEN PARENTS ... AND GRANDPARENTS ... FAIL TO PLAN

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I. INTRODUCTION

Our clients are families who are diligently planning for their child with special needs to ensure future quality of life for the child. This includes planning for ongoing eligibility for government benefits. Parents may work with a general estate planner who is not sensitive to the benefit eligibility issues and drafts the plan so it is ineffective. Grandparents may have trusts which were drafted decades earlier, are now irrevocable, and did not contemplate the individual's disability or benefit eligibility. And family members or friends may name the child as beneficiary on an asset, or leave an outright bequest to the child. And finally, there are the people who simply fail to plan, or die unexpectedly, and the child is now an heir of the intestate estate. What are the options when the individual becomes the outright beneficiary of property which puts them over resources and causes the loss of SSI and Medicaid? What can we do when the individual with a disability is the beneficiary of a now-funded, now-irrevocable trust which is a countable resource for benefit eligibility.

There are a number of solutions available to resolve these problems and allow you to become a hero in the eyes of the client. Some of these are dependent on your state law, while others rely on provisions in common law or the Uniform Trust Code. This presentation will address both of the following

situations: (1) when the individual is the beneficiary of an outright distribution of property, and (2) when the individual is the beneficiary of a countable trust.

II. DEALING WITH AN OUTRIGHT DISTRIBUTION OF PROPERTY

A. Use a Self-Settled Trust or ABLE Account

If the individual needing benefits receives an outright bequest or is named as beneficiary on an account or other asset, the easiest way to deal with it is to transfer the asset into a self-settled (d)(4)(A) special needs trust or a (d)(4)(C) pooled trust[1] or, if it is small enough and the beneficiary qualifies, into an ABLE account.[2] The inheritance will still be income in the month it is received, but if transferred prior to the end of the month, only a month of benefits will be lost. Depending on how SS counts an inheritance as available in your region, you might stretch out distributions to an ABLE account over two or three years, e.g. $15,000 in December, $15,000 in the following calendar year and another $15,000 if you can wait until the following January to close the estate.

SSI bases its determination of when an inheritance is available on state law. Make sure you know how the potential inheritance will be treated in your state or region.[3] Region V (Chicago region) states that in all states in the region an individual has some alienable property interest, whether it is an interest in the actual property inherited or a beneficial interest in the estate, as of the decedent's death. This interest would constitute income as of the date of death, and a resource

[1] 42 U.S.C. § 1396p

[2] Before the passage of OBRA 93 in 1993, we would spend down as much of the inheritance as possible by the end of the month, and turn the remaining funds over to the state to maintain Medicaid eligibility. We've come a long way since then!

[3] POMS SI § 00830.550 B.2. POMS SI 01120.215 addresses how to determine a resource if an estate is unprobated.

in subsequent months.[4] In reality, if we demonstrate that there is no way to determine the amount available for distribution because of claims against the estate or because the assets have not yet been determined, SS has been reasonable about not counting the inheritance as available. They are less reasonable when there is a fixed cash bequest, or if the beneficiary is inheriting real estate, which immediately vests in the beneficiary.

If there is no regional guidance, SS will use the earlier of the date the individual received the inheritance (using a statement either signed or recorded from the individual or documents in the individual's possession); or the date the estate is closed, determined by contacting the court or the estate attorney.

B. Disclaimer

Disclaimer of assets to which the beneficiary is legally entitled is an improper transfer of resources for both SSI and Medicaid.[5] If you have a beneficiary on SSDI and a community Medicaid or MAGI Medicaid program, disclaimer may be a good option because these programs don't penalize transfers. If you opt to use a disclaimer, make sure you understand who will receive the disclaimed property. I have seen several cases where the person or people who were assumed by the parties to get the disclaimed property was not who received the property. The property must be distributed as though the beneficiary predeceased the decedent, so it may go to the other named beneficiaries if the bequest was "in equal shares to a class of beneficiaries who survive me," or, if to the beneficiaries, per stirpes, to the beneficiary's children.

[4] POMS SI § CHI00830.550 F.

[5] OBRA 93 made disclaimer an improper transfer for Medicaid. HCFA specifically states that "[w]aiving the right to receive an inheritance" is an example of a disqualifying transfer. Health Care Financing Administration State Medicaid Manual, pt. 3, S 3257B (3).

C. Modify or Reform the Will[6]

Historically, trust law has looked at the intent of the settlor of the trust as paramount. Not so for the testator - the language of the last will and testament controlled, even if there was evidence that it did not reflect the decedent's actual intent. No extrinsic evidence was allowed unless the language in the will was ambiguous. The concept of reformation of wills based on mistake was adopted in the 2008 amendments to the Uniform Probate Code.[7] UPC Section 2-805 allows a court to reform the will, even if unambiguous, to conform to the decedent's intention if such intention is proved by clear and convincing evidence and the terms of the will were affected by a mistake of fact or law.

A number of states have adopted this provision. But keep in mind, reformation is not available to correct a failure to prepare and execute a document. Nor is reformation available to modify a document in order to give effect to the donor's post-execution change of mind or to compensate for other changes in circumstances. This is probably not a useful action to bring except under certain very limited circumstances, unless you are in Texas.

In 2015, Texas enacted Section 255.451 to its Estates Code, Circumstances Under Which Will May Be Modified or Reformed. The statute provides that the personal representative of the decedent can petition the court to modify or reform the terms of a will. The court may direct or permit the personal representative to perform acts that are not authorized or that are prohibited by the terms of the will,

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[6] *See* Reformation of Wills: The Implication of Restatement (Third) of Property (Donative Transfers) on Flawed but Unambiguous Testaments. Clifton B. Kruse, Jr., ACTEC Notes, Vol. 25, No. 4, Spring 2000, for a comprehensive discussion of the "Plain Meaning Rule" and the historic exclusion of extrinsic evidence to prove the testator's intent. The author argues that the extrinsic evidence rule has frustrated testators' intent, and that the Restatement (Third) of Property, which emphasizes the importance of the donor's intent over the plain language of the Will leads to a more just outcome.

[7] UPC § 2-805 (amended 2010) allows reformation of any governing instrument, including but not limited to deeds, wills, trusts, insurance policies, and beneficiary designations.

or prohibit the personal representative from performing acts that are required by the terms of the will, if "(2) the order is necessary or appropriate to achieve the testator's tax objectives **or to qualify a distributee for government benefits** and is not contrary to the testator's intent."

Until your state adopts similar statutory language, it is important to include a provision in all wills you draft allowing the personal representative to pay a bequest or residual share for a beneficiary who is disabled to any existing supplemental needs trust for that individual, or to establish an appropriate trust and pay the bequest or residual share directly to the trust. This will avoid negative outcomes for any beneficiary who is disabled, unknown to the testator, or who suffers a later disability. We also provide a "Friends and Family Letter" (Appendix A) to our clients, to provide to others who they believe are likely to leave something to their child with a disability. This letter explains that funds left to the child should be directed to the child's trust, and we provide the appropriate language to name the trust as beneficiary or as recipient of a bequest.

III. DEALING WITH A COUNTABLE TRUST

The paradox of trusts that count as a resource to the beneficiary is that so long as any funds in excess of the resource limit remain in the trust, the beneficiary loses eligibility for benefits. No consideration is given to the extent of the beneficiary's interest in the trust, or the interest of the remainder beneficiaries. Fixing such a trust to protect the beneficiary's eligibility also protects and benefits those with remainder interests.

Always look first to the trust document to see if there are any provisions which allow the modification of the trust. Perhaps the trustee has a power to amend for certain circumstances, or a trust protector is named who has such a power. If the

trust itself does not address modification, there are a number of ways, both judicial and non-judicial, to go about fixing trusts, depending on your state trust code and Medicaid law. These include modification, which changes the terms of the trust going forward, reformation, which seeks to fix errors in the trust and relates back to the time the trust was created, and decanting, which pours the trust over into a new trust. All three of these options will be discussed, along with trust merger, and irrevocable assignment of trust interests. This article will focus on the Uniform Trust Code and The Uniform Trust Decanting Act. It is important to understand the law in your jurisdiction concerning these methods, as well as the laws for benefit eligibility and trusts, which varies significantly among the states.

A. Decanting

"Decanting" occurs when a trustee appoints trust property in favor of another trust. The underlying principle of decanting is that a trustee with discretion to make distribution of principal for the benefit of a beneficiary may exercise that power by making a distribution in further trust for such beneficiary. Decanting basically allows a trustee with discretion to modify the terms of the trust.

Decanting is a flexible and efficient means of modifying a trust, because it allows the trustee to distribute property to an entirely different trust with different terms. Twenty-nine states have statutes authorizing trust decanting as of the beginning of this year[8]. Decanting statutes provide the default rule for trusts, but the terms of a trust may override the rules provided by decanting statutes.

[8] See Steve Oshins, *7th Annual Trust Decanting State Rankings Chart at* https://db78e19b-dca5-49f9-90f6-1acaf5eaa6ba.filesusr.com/ugd/b211fb_ad72a49164924ba58ed62863303877cb.pdf for a summary of the various states decanting statutes.

In general, these statutes require discretion to invade trust principal (in some states it must be absolute or unfettered discretion, while in others, a power to invade for best interest, welfare, comfort or happiness is sufficient). In a number of states, a trust with an ascertainable standard cannot be decanted into a discretionary trust, and, if the trustee does not have discretion to distribute income, exercise of the decanting power cannot reduce the fixed income of any beneficiary. The exercise of the power must be in favor of the beneficiaries of the invaded trust. The decanting procedure generally does not require court involvement or approval, but does require notice to all beneficiaries in almost every state.

The Uniform Trust Decanting Act, Section 13, provides for decanting a trust for a beneficiary with a disability. The beneficiary does not need to be receiving benefits, but the trustee must reasonably believe the person could qualify for disability-related benefits. This provision allows decanting to a trust which will not be counted as a resource for eligibility purposes, even if it changes the special needs beneficiary's interest in the trust. The decanting must be in furtherance of the purposes of the first trust and may not change the beneficial interests of any other beneficiaries under the trust.

Common law provides some tenuous support for common law decanting. A trustee's discretionary power to make distributions "to or for a beneficiary" permits the trustee to designate beneficial interests. Since a trustee has legal title and not equitable ownership, a trustee holding a discretionary power holds a non-general power of appointment over trust property. Restatement (Third) of Property, §§ 11.1 (comment d.) and 12.2. Therefore, unless otherwise limited in the document, the holder of a power of appointment, general or otherwise, may exercise the power to make a distribution of property either outright or in further

trust, unless the powers are expressly limited in the trust document. Restatement (Third) of Property, §§ 12.2, 19.3.

Rather than relying on common law, a better practice is to move the situs of a trust to one of the states with liberal decanting statutes, decant the trust, and move the situs back to the original state if desired.

B. Modification of a Trust by Consent of Beneficiaries and Settlor

Section 411 of the Uniform Trust Code provides authority for modification or termination of a trust upon consent of all beneficiaries and the settlor, even if the modification or termination is inconsistent with a material purpose of the trust. The settlor's consent may be given by an agent under a power of attorney if such authority is specifically conferred in the power of attorney or the trust, or by a conservator or guardian if local law allows. The trustee's consent is not required, but the trustee has standing to object. If a beneficiary does not have capacity to consent, modification under section 411(a) may still be possible using the concepts of representation or appointed representatives.

Check carefully to ensure that all "interested persons" have consented. For minor, incapacitated, or unborn beneficiaries, using virtual representation or appointing a guardian ad litem is necessary. Article 3 of the UTC expands the use of these forms of binding representation outside of judicial settlements.

The UTC allows virtual representation and other forms of representation where there is no conflict of interest, including the following:

1. The holder of a general testamentary power of appointment may represent the interests of permissible appointees and takers in default (§ 302);
2. Fiduciaries may represent those to whom they owe fiduciary duties (§ 303);
3. Parents may represent minor or unborn children (§ 303);
4. A person with a substantially identical interest may represent a minor, incapacitated or unborn individual, or a person who cannot be located (§ 304).

Article 3 is a default provision. A settlor may specify in the trust document their own methods for providing substituted notice and obtaining substituted consent.

C. **Court Modification or Reformation**

A Settlor can limit or prohibit non-judicial settlements in the trust document. However, the UTC prohibits the settlor from limiting the power of the court to modify or terminate a trust.[9] The power of the court to modify or terminate a trust under §§ 410 -416 is not subject to variation in terms of trust. The underlying reason for this rule is that the terms of a trust cannot deny a court authority to take actions necessary in interests of justice…The power of the court to modify or terminate a trust under §§ 410 -416 is not subject to variation in terms of trust.

A trustee or beneficiary may begin a proceeding to approve or disapprove either a proposed modification or termination under §§ 411-416, or a trust combination or division under § 417. The settlor may commence a proceeding to approve or disapprove a proposed modification or termination under § 411.

Modification can be made due to unanticipated circumstances or inability of the trustee to administer the trust effectively. UTC §412. This argument can be used to add special needs provisions to a trust when the disability of the beneficiary or the future need for public benefits was not known when the trust was drafted. The court must find that the modification of the trust will further the purposes of the trust, and, to the extent practicable, should be made in accordance with the settlor's probable intent.[10]

[9] UTC Section 405(b)(4)

[10] Trusts may also be judicially modified under the UTC if the trust is uneconomic, or to achieve the settlor's tax objectives.

Texas, as in their statute for reformation of wills discussed above, also allows for modification of trusts to qualify a beneficiary for public benefits.[11]

If not all of the beneficiaries consent to a proposed modification or termination of the trust under subsection (a) or (b), the modification or termination may be approved by the court if the court is satisfied that if all the beneficiaries had consented, the trust could have been modified or terminated under this section; and the interests of a beneficiary who does not consent will be adequately protected. UTC § 411(e). Even if all parties consent, any party can request a court to approve a non-judicial settlement agreement and ask the court (1) to determine whether the representation was adequate, and (2) whether the agreement contains terms and conditions the court could have properly approved.

Section 411(e) is similar to the position in the Restatement.[12] It addresses situations in which a termination or modification is requested by less than all the beneficiaries, either because a beneficiary objects; the consent of a beneficiary cannot be obtained; or, representation is either unavailable or its application uncertain.

D. Merger and Division of Trusts

Section 417 of the UTC provides that a trustee may combine two or more trusts or divide a trust as long as the action will not "impair rights of any beneficiary or adversely affect achievement of the purposes of the trust."

Merger may be done simply to consolidate multiple trusts established for the same beneficiary for ease and economy of administration. Merging two trusts for a beneficiary with a disability, one of which has an appropriate distribution standard

[11] Texas Property Code § 112.054
[12] Restatement (Third) of Trusts § 65 Comment c

and one of which has a support standard, under the terms of the trust with the proper distribution standard can clean up the problematic trust, so long as it does not impair the rights of the beneficiary. Other reasons to merge might be to change the successor trustees or add a trust protector. In a case where the beneficiary has mental health issues and it is better he not have information about the trust, one might want to change the situs of the trust to a state in which notice provisions for beneficiaries are more lenient.

Dividing a trust is useful if you have decided that transfer to a first-party trust makes the most sense, and if there is a class of beneficiaries, one of whom has a disability. The value of the beneficiary's interest can be calculated and paid to the first-party trust, while protecting the interests of the other current beneficiaries as well as the remainder beneficiaries.

The right to merge or divide trusts is subject to other terms in a trust. Although the trusts need not have identical provisions to allow for a merger, if the dispositive terms of the trusts differ or conflict, the less likely they can be merged because that could impair some of the beneficiary's interests. § 417, Comment. Prior to merging or dividing trusts, the trustee must notify the qualified beneficiaries of the trusts which will be combined. A court does not need to approve a merger or division of trusts nor must the beneficiaries consent. If the terms of the trusts differ substantially, the trustee should seek court approval or at least obtain the consent of the beneficiaries. *Id.*

Section 68 of the Restatement (Third) of Trusts is virtually identical to the provisions contained in § 417 of the UTC. "The trustee may divide a trust into two or more trusts or combine two or more trusts into a single trust, if doing so does

not adversely affect the rights of any beneficiary or the accomplishment of the trust purposes."

E. Invoking the Spendthrift Clause in a Support Trust

If a trust is countable because of an ascertainable standard, but the trust's spendthrift clause provides that the trust will be administered as a wholly discretionary trust if the beneficiary attempts to assign his interest, or if a creditor or some other entity attempts to reach the interest, the Trustee can invoke the spendthrift clause in writing. A statement that the trustee will administer the trust going forward with sole discretion may be enough to satisfy your Medicaid agency and SSI.

F. Irrevocable Assignment of Beneficiary's Interest in a First Party Trust

One of my favorite tools is using an irrevocable assignment of the beneficiary's interest in a countable trust to a first party special needs trust. This is not feasible when the spendthrift clause in the trust prohibits assignment of a beneficiary's interest, but I find that many older trusts allow assignment with prior written consent of the trustee. The primary advantage of this technique is that only distributions from the trust are transferred to the SNT, rather than the entire trust corpus. The primary trust is then available for distribution to remainder beneficiaries upon the disabled beneficiary's death. A sample Assignment is attached as Appendix B.

Why is this effective? As discussed above, the beneficiary can't just disclaim his interest, as a disclaimer is considered an improper transfer for purposes of Medicaid and SSI. This creates a penalty period of up to three years

for SSI, and may create a transfer penalty for Medicaid, depending on the program in which the beneficiary is enrolled.[13] But for SSI and Medicaid, there is an exemption for transfer of resources to an exempt trust under 1396p(d)(4)(A) or (d)(4)(C) prior to age 65.

Check your state law. Some states prohibit assignment of a beneficial interest in a trust in certain circumstances.[14] A trust beneficiary in New York may not transfer his income interest in a trust unless the trust confers a power to transfer. Michigan bars an assignment of the beneficiary's interest in land.

Next check the spendthrift provision in the trust. If the beneficiary's interest simply terminates upon the attempt by the beneficiary to transfer it, this method won't work. However, if the provision allows assignment of the beneficiary's interest with prior approval of the trustee, and the trustee is willing to consent this technique should be effective. In some trusts, the beneficiary's interest becomes discretionary upon voluntary or involuntary alienation of the interest. The interest of the beneficiary can still be assigned.

What exactly is transferred to the SNT? If the beneficiary has an income interest in the trust, the SNT will receive the income going forward. If the trust provides for distributions of principal on a predetermined schedule, those distributions will be made to the SNT as well. It gets a little more complicated if the trust is discretionary. Restatement (Third) of Trusts, section 60, discusses what is transferred when a beneficiary assigns his interest in a discretionary trust. The "transferee … of the beneficiary is entitled to receive … any distributions the trustee makes or is required to make in the exercise of that discretion after the trustee has knowledge of the transfer."

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[13] POMS SI 01150.010 – a transfer any money or property which you and your spouse have a right to get but don't get because of something you or your spouse did, or someone else did who was acting for you or at your request.

[14] See Restatement (Third) of Trusts, Section 51, Comment a

Once the assignment is complete, the trustee is prohibited from making any distributions from the trust to the beneficiary. The trustee is also prohibited from making distributions for the benefit of the beneficiary by paying from the trust to providers of goods or services to the beneficiary. Distributions may only be made to the trustee of the SNT, who can then use the funds for the benefit of the individual. The SNT only acquires exactly what the beneficiary had. Standards governing the discretion of the trustee still refer to the assigning beneficiary and his needs. The trustee can refuse or limit distributions to the SNT to the same extent the trustee could have denied or limited distributions to the beneficiary.[15]

IV. CONCLUSION

When deciding how best to repair a broken estate plan, cost and efficiency must be balanced with the best long-term outcome for the beneficiary with special needs, while also protecting the interests of other beneficiaries. Using any of the techniques discussed here, you must keep foremost in mind the eligibility requirements for the benefits you are trying to protect. It may seem attractive to avoid going to the court for approval but if all beneficiaries consent to an action, getting the court's approval may be more persuasive to the benefit agencies. You may practice in a jurisdiction which is very negative about Medicaid planning, and going to court may be the kiss of death. In those places, decanting, or modification by agreement of the parties may be most attractive. Think carefully about using a first party trust to hold the beneficiary's share if an alternative is available. Although it may be the quickest, most cost-effective way to resolve the problem, advise the clients in writing that by going this route they are exposing the assets to payback when it might have been avoided.

[15] Restatement (Third) of Trusts, Section 60

Finally, draft all of your documents to include the flexibility to avoid problems, or easily fix them if they arise.