Top Ten (Maybe even Fifteen!) Mistakes Made in Drafting & Administering Special Needs Trusts

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by

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1. Introduction[1]

Consider the following all-too-real hypothetical:

It's 4p.m. on a Friday afternoon. You are just beginning to close your briefcase and head out for the weekend when your phone rings. It's Marvin the Med-Mal Maven, an attorney whose advertisements you've seen and heard but have never met. He informs you that he has just settled the biggest case of his career. It's a multimillion dollar settlement of a personal injury case involving a 19 year old young woman, Giselle, a ballet prodigy who was hit by a car rendering her a paraplegic. She has decision making capacity and is firmly convinced she will dance again and wants the settlement funds directed towards making that happen.

Marvin, the defendants, the structured settlement brokers, life care planners and the young girl's mother, had all agreed on the terms when the mother informed Marvin that her best friend had asked why the monies weren't going into a Special Needs Trust? Marvin consults with the structured settlement brokers and the life care planner who all agree that's not a bad idea (especially given the kind of long-term therapy and surgeries Giselle may need if it appears she can dance again), and why didn't they think of it first. Giselle's Uncle Freddie has agreed to serve as Trustee because he used to be a bookkeeper and worked for an investment firm. Giselle's mother suggests that Marvin

[1] My thanks to my "cohorts in crime," Bridget O'Brien Swartz, Howard Krooks and A. Frank Johns for their contributions to the this paper. That said, it should be noted that none of them have ever made any of these mistakes.

contact you to send him one of those "special needs trust thingies" so he can take it to the Judge on Monday (when they've all been ordered to appear to put the settlement on the record.)

You explain to Marvin that it's not quite that simple and suggest that he get the matter continued so that you can meet with Giselle, her mother, Uncle Freddie and the other players involved so that you can do your job as well as Marvin has done his. With some grumbling Marvin agrees and a meeting is set for the following week.

Everyone is present at the meeting. Marvin tells you the story and what, in his opinion, the terms of the trust need to be, while Giselle and her mother sit there and nod. Whenever you try to talk to Giselle, her mother, or Uncle Freddie, Marvin interrupts, giving you what he believes is the correct answer. Everyone urges you to ***please*** prepare the Trust since they have to be back in Court in two days. You, feeling pressured but are sure your “standard” SNT will work just fine, promise to have it to them tomorrow. Having observed Giselle, you believe you have enough information to move forward without reviewing the life care plans, her medical records or having any further conversations with her mother or her. You ask your paralegal to printout “our form SNT”, glance at it to make sure everyone’s names are spelled correctly and send it off the Marvin.

What could possibly go wrong....?

2. **Failing to Identify who the Client Is**

In ***any*** representation, job one is to identify who you are representing. Failing to do that at the earliest possible moment can often/usually be the first cascading domino in

a veritable collapsing house of cards (mixed metaphor intentional) of misunderstandings, frustration for you and all of the people involved (some or all of whom believe they are your client (or think they ought to be). In the hypothetical it is conceivable that:

a. Marvin thinks he's your client because he called you and/or because he believes he's going to be calling the shots;

b. Giselle thinks she's your client because she's the reason everyone is sitting around the table and it's her life and future we're all talking about;

c. Giselle's mother thinks she's your client because she's Mom; and

d. Uncle Freddie thinks he's the client because he's going to be the Trustee (whatever that means – he's not sure).

It is for this reason that NAELA Aspirational Standard B.1 states:

> "The elder law and special needs law attorney identifies the client and the individuals who will assist the client at the earliest stage of the representation, obtains the client's agreement on these identifications, and communicates this information to the persons involved."[2]

You could represent Marvin whose firm is retaining you, on their behalf, to draft the SNT for their client. You could represent Giselle. You could represent Mom.

Whatever choice you make it should be in the context of AS A.1 which states:

> "In applying a holistic approach to legal problems [the attorney] works to

[2] NAELA Aspirational Standards for the Practice of Elder and Special Needs Law (hereafter "AS"), 2nd Ed. 2017, NAELA Journal Special Edition 2018

consider the larger context, both other legal consequences as well as the extra-legal context to which the problems exist and must be solved."[3]

And once you've done that, you meet with the prospective client privately at the earliest practicable time to assess capacity, the client's wishes and the possibility of the presence of undue influence.[4]

3. **Failing to Communicate who the client is to the family and what that means**

Assume you've decided that your client is Giselle. She may be young, but she's smart and has a very clear understanding of what she wants and what her future looks like. As suggested in A.S. B.3 you now invite everyone in the room to leave so you can meet with Giselle privately. Giselle tells you that (a) she trusts Marvin and welcomes his advice moving forward and because this is all that "legal stuff," wants him to be kept in the loop; and (b) she also values her mother's advice, but wants it to be made clear that the final decisions are hers, not her mother's. You explain to Giselle that you can do this - that she will sign a retainer agreement with you; that she will authorize you in writing to continue to communicate with Marvin and her mother to whatever extent Giselle wants after you review in detail the impact such authority may have on the attorney-client privilege and

confidentiality..

[3] AS A.1
[4] A.S. B.3

You're now going to bring everyone back in and explain how things are going to proceed from this point, setting out as clearly as you can the boundaries of attorney confidentiality and attorney-client privilege as they are going to apply in this matter moving forward.

4. **Drafting a Third Party Trust with "payback" provision** Rule 1.1 of the ABA's Model Rules of Professional Conduct states:

> "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.[5]

MRPC Rule 1.0(h) defines "reasonably" as follows:

> "Reasonable" or "reasonably" when used in relation to conduct by a lawyer denotes the conduct of a reasonably prudent and competent lawyer."[6]

Mistakes happen. In this case, the mistake (whether by oversight or ignorance) of creating a third party SNT with estate recovery language that is only applicable to first party trusts under 42 USCA §1396p(d)(4)(A) and the corresponding Regulations & POMS, has the result of exposing assets that would otherwise not be subject to a claim for reimbursement by the state Medicaid Agency to an enforceable claim by the Agency. Attorneys who have made this mistake have found themselves subject to malpractice

[5] ABA Model Rules of Professional Responsibility (MRPC) 1.1

[6] MRPC 1.1(h).

claims and disciplinary proceedings. In a number of cases, efforts by the attorney to modify the trust retroactively have failed. "I pulled up the wrong template on my computer" is not a defense.

5. **Drafting a First Party Trust without a "Payback" provision**

This is the flip side of the previous mistake. However in this case, the ramifications are potentially much worse since not including the appropriate "payback" provisions in a first party special needs trust will cause the Beneficiary to lose their eligibility. And even if a court agrees to modify the trust retroactively, the Social Security Administration may not honor the Order retroactively, but only prospectively.

6. **Adding Third Party Funds to a First Party Trust or *vice versa***

New hypothetical: Your client tells you that she was just told her late brother left $10,000.00 to her daughter's special needs trust. Unfortunately, the special needs trust to which she is referring is the first party special needs trust you created for the daughter some years ago after the daughter was injured in an automobile accident. It is unlikely that the transaction can be reversed, especially if the brother's trust or will specifically names his niece's trust as the recipient. Perhaps the brother's drafting attorney should have contacted your client (or you) to make sure the gift was being worded properly. Did the brother's attorney commit malpractice?

On the flip side, grandfather creates purely discretionary trusts for each of his grandchildren providing that the Trustee can make distributions of income and/or principal to each of the grandchildren on essentially an HEMS (health, education, maintenance and

support) basis. One of the grandchildren is receiving public benefits and doesn't want to lose them if the Trustee of the grandfather's trust were to make distributions to her. She goes to an attorney who prepares a third party special needs trust and sends her on her way. She takes the trust to the Trustee of the grandfather's trust and says "I now have a special needs trust. Please make distributions to my new trust." The Trustee, on the advice of counsel declines to do so. Why? Because the grandfather's trust only authorizes the Trustee to make distributions solely to the Beneficiary and to no one else. The Trustee's attorney tells the granddaughter that if the Trustee makes distributions to her, she will be disqualified from receiving public benefits because it's her money (first party) and she cannot contribute it to a third party trust. It seems clear under these facts that the granddaughter's attorney failed to carefully read the grandfather's trust. He should have prepared a first party trust and advised the granddaughter to immediately transfer funds she receives from the grandfather's trust into her first party trust. On the other hand, if the grandfather's attorney had given the Trustee authority to make distributions "to or for the benefit of" the granddaughter, the necessity of having two trusts might have been avoided.

7. **Failing to clearly understand the nature of the Beneficiary's disability**

As someone once said, "trust, but verify." Once you accept an engagement to create a SNT one of the first questions you'll ask is "what is the nature of the Beneficiary's disability?" From there you (hopefully) will seek more details about (a) severity; (b) long term prognosis for either improvement or not, or worse; (c) are there treatments or

procedures such as corrective surgeries indicated as the Beneficiary matures; and (d) any other information you deem relevant. Depending on the situation, it may behoove you to get multiple answers to these questions.

For example, MedMal Marvin will certainly provide you with a copy of the life care plan he obtained to bolster his case. It probably takes a very pessimistic view of his client's long-term prognosis. Viewing the defendant's plan might give some perspective and might be worthwhile reviewing. But what about the Beneficiary herself? Her opinion certainly counts as does that of her parents. The more information you can glean, the better document you're going to be able to produce.

For example, in the real-world version of this hypothetical, it was extremely useful to research exactly what kinds of experimental treatments and surgeries the Beneficiary and her family were contemplating. Doing so enabled me to craft specific protections for the Trustee regarding exposure to liability in authorizing experimental treatments, pharmaceuticals, therapies etc.

8. **Making distributions from a Third Party Trust prior to making distributions from a companion First Party Trust**

In those situations where you have both a third party trust and a first party trust, good planning and drafting should include provisions in both trusts (if possible) directing the Trustees as to which trust should be the first to make distributions in any given circumstance. If there is no such specific language in the trusts, the Trustees should agree between themselves as to the sequencing and commit that to writing.

9. **Not advising a non-professional (or even a professional) fiduciary on the "do's & don'ts" of appropriate distributions, and why administering a SNT is SOOOO different than other Trusts.**

In situations where you are not representing the Trustee, you may not have an obligation to instruct her/him as to the intricacies of SNT management, but I think at the very least, especially if you have doubts about the Trustee's ability to do the job (*i.e.* Uncle Freddie), you owe your client, whether it be the Settlor or the Beneficiary, an obligation to give them a "head's up" as to the difficulty of the task ahead and the potential for harm to the Beneficiary if the administration is not handled properly.

10. **Drafting SNTs without regard to various POMS provisions directly on point or using improper language that contradicts a POMS provision directly on point**.

We love to be creative. Many of us relish the challenge of drafting documents that present unique factual issues and there is certainly a place for that in drafting a SNT. **HOWEVER**, as Meredith Willson observes in the very opening of "The Music Man" - "ya gotta know the territory." In this case, the "territory" is the POMS. Your creativity will be of no use (and may create serious problems) if you haven't established a foundation that is compliant with the relevant POMS. And the POMS, and the interpretation of the POMS is anything but static. The simplest example is that on September 30th of this year, "food" will no longer be a disqualifying distribution from an SNT. And (unfortunately) the interpretation of the POMS can vary widely. So it is incumbent on us to stay on top of not

only what the POMS say but also what our local Regions and even local offices *think* they say.

In addition to the POMS, we of course need to pay attention to our respective State's Medicaid Regulations and policies which may require state-specific language. For example, in Arizona, a first party SNT must refer to the state statute and corresponding policy, particularly as it relates to "allowable disbursements" and the payback.

11. **Not adequately discussing the appropriate use of a Bond**

When the Trustee is going to be someone other than an institutional Trustee, there should be a discussion as to whether it is appropriate for the Trustee to obtain a fiduciary Bond. Where Uncle Freddie is going to be the Trustee, this can create a ticklish situation both for the family and for Uncle Freddie. When the immediate answer to my question "do you want Uncle Freddie to post a Bond in order to protect the Beneficiary?" the knee jerk reaction is usually,"Of course not, Uncle Freddie is very trustworthy." How you respond is up to you, but I believe pushback is appropriate. Strong pushback. Of course at the end of the day, we do what our clients tell us to do, but also at the end of the day, when Uncle Freddie is on a beach in South America with the trust's corpus as his retirement fund, we also know that the clients will be pointing a finger at us and saying "you should have insisted!."

12. **Funding a third party SNT with funds held in the Beneficiary's UTMA Account**

Most parents or Custodians of UTMA Accounts don't give much thought to the reality that the funds in the account belong to the minor from the moment of funding. In fact, many parents go to great lengths to make sure their children don't know the money is theirs for the asking after they reach majority. As a result the parents may ask you if they can take the funds out of the UTMA Account and put it into the third party SNT that you are creating for them. The answer is "no." Generally speaking the TIN for the UTMA account will be the child's social security number which makes it easy to point out that it is the child's money. However, even in those situations where an independent EIN is obtained for the account, the funds, as a matter of law belong to the minor, *ergo* a first party SNT is the proper vehicle. It goes beyond the scope of this discussion as to what authority the parents (or other Custodian) may have to transfer the UTMA Account into a first party SNT without the consent of the child.

13. **Failing to properly advise clients regarding the use of structured settlements**.

Structured settlements and annuities certainly have their place. However, frequently we, as the drafting attorneys, are the only ones who can objectively see the whole picture and give advice (assuming we have the experience and expertise to do so) on whether or not a structured settlement or annuity is appropriate in this particular matter.

14. **Failing to properly analyze the advantages/disadvantages to using Trust Advisors or Trust Advisory Committees**

Everything I said above regarding structured settlements and annuities applies to the use of Trust Advisors and Trust Advisory Committees as well. They have their place.

15. **Poorly and/or inconsistently drafted definitions of "disability" or "special needs, especially in the context of qualifying the SNT under SECURE Act 2.0."**

We need to keep in mind that the words “disabled” and “disability” have different meanings under different statues (SECURE ACT 2.0 being the most recent). As a result it is important to try to make our terminology as consistent and “statute friendly” as possible.

As an example, a colleague is currently involved in the administration of a trust that leaves IRAs to multiple beneficiaries, one of whom thankfully qualifies as "disabled" under the new Final Regs of the SECURE Act 2.0, but does not meet the definition of "special needs" under the terms of the trust allowing for retention of the interest in a third party SNT. Although, this likely can be decanted or reformed by court order. The definition of "special needs" in this trust requires the Beneficiary to be receiving Social Security disability or SSI benefits.