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Special needs trusts and other options can preserve eligibility for needs-based public benefits

By Sam Friedenberg, Attorney at Law

The situation is familiar to many of us: a minor or an adult with disabilities is to receive funds that will disqualify him or her from needs-based public benefits.[1] The funds may be an inheritance, a personal injury judgment or settlement, a dissolution award, or a gift. We are asked for a solution to the problem. Most lawyers today are aware that a special needs trust (SNT) is the answer. (Sometimes these are referred to as supplemental needs trusts or disability trusts.) Twenty years ago this was not common knowledge, and the road is littered with inappropriate support trusts that promptly disqualified the beneficiary.[2] The following is a discussion of the practicalities of the SNT and an exploration of other options in this situation.

The special needs trust

When the disabled beneficiary has received or has a vested right to the funds, the SNT is "self-funded." This is different from a third-party-funded SNT, which arises from a planned gift or inheritance. A self-funded trust is authorized by OBRA 93. PL 103-66 codified at 42 USC 1396p (d)(4)(A) and OAR 461-145-0540(9)(a). These laws implement Congress's intent to allow disabled people to receive funds that would improve their quality of life without disqualifying them from benefits. If the trust meets the necessary statutory requirements, it is exempt from consideration from most benefit programs. Further, a transfer of assets to the trust does not create a period of ineligibility for the benefit. Precise guidelines can be found in the Social Security Programs Operations Manual System (POMS). See POMS SI 01120.201 *et seq.*

The statutes require that the SNT be established before the beneficiary turns age 65—although the trust may continue beyond age 65. It may be established by a parent, grandparent, guardian,[3] or court. Of course the disabled beneficiary is the party who contributes the funds to the trust, but this discrepancy is just accepted as an oversight of the federal law. When the beneficiary dies, the trust must distribute funds to the state up to the amount that the state paid in benefits.[4]

In addition, the trust should be drafted consistent with statutory and common law requirements and principles of good practice. First, the beneficiary cannot be the trustee. The reason, of course, is that direct access and control suggests that the funds are available notwithstanding the distribution terms of the trust. Second, the beneficiary cannot have the ability to demand distributions. Third, the distribution standard must be discretionary with the trustee. Ordinarily, the standard allows distributions for "special" or "supplementary" needs. (These terms are explained below.) Although some practitioners have used pure discretionary trusts without the special needs standard, this author refrains from such use.

The SNT is of great benefit to disabled beneficiaries, but a client may balk at turning over control to a trustee or a court or to have the money reserved for limited purposes. Here are

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some of the practical questions that arise:

What is a special or supplementary need? The best definition is a good or service that will improve the beneficiary's quality of life, is not "support" as defined by public benefit providers (e.g., food and shelter), is not reimbursable by a public-benefit provider, and is not cash that could be converted into support.

What else can the distribution standard permit? Distributions can be allowed to purchase assets that are exempt under the relevant public benefit law. Some trusts even allow purposely disqualifying distributions so long as the parties agree to them. There is some risk in this.

If a parent or grandparent is available, do we need to go to court to establish the trust? The trust is equally valid whether established by a parent, grandparent, guardian, conservator, or court. If there is an already established conservatorship, the conservator will need to petition the court for authority to establish the trust. ORS 125.440. However, even if there is no need to petition for court authority, it may be the better option. Some clients will be better protected with court supervision. The usual requirements of bond and annual accountings are particularly important where the family has no responsible trustee. An attorney who does not seek court approval may be liable for not diligently protecting the trust beneficiary from a trustee if the trustee later misuses his or her authority.[5]

If the trust was created while the disabled person is under a conservatorship, can the conservatorship be terminated? Historically, it has been extremely difficult to terminate a conservatorship by merely establishing a trust. Multnomah County, for example, had (and may still have) a formal policy that it would not terminate the conservatorship unless funds were less than $10,000. However, the passing of HB 2360, effective January 1, 2008, and codified as ORS 125.440(2), opens up the possibility that a party may petition the court to terminate the conservatorship. The statute provides that a court may grant a petition that has the effect of terminating a conservatorship if it finds that (1) the trust is created to establish or maintain the protected person's eligibility for needs-based public benefits, (2) the assets do not exceed $50,000, (3) the purpose of the conservatorship was to create the trust, or (4) other good cause. Of course, the decision is still at the court's discretion, and the philosophy of the judge may trump any showing of good cause.

Are there limits to what can be placed in an SNT? This issue of what types of assets can be put into the trust is a threshold question for the planner. An SNT is best funded with traditional investment assets such as cash, stocks, mutual funds, and real estate. Some assets clearly cannot be placed in an SNT—including Social Security income, and pension assets (without liquidation)—and some assets cannot be owned by trusts, such as stock options. The law is unclear regarding streams of income like spousal support and annuities. The Department of Human Services in Oregon is reviewing its policy about whether these assets can be put into an SNT. There should be no problem with structured annuities that are ordered payable to the trust.

Why establish an SNT if the balance at death may have to be paid to the state? An SNT is not a wealth-transfer mechanism. Its purpose is to improve the quality of life for persons with disabilities. It is a good idea to explain to clients that if the trust is managed well, the last disbursement will occur just before the beneficiary passes away. For the most part, clients accept this. An exception is clients with minor children who want to leave a fund to educate and support them. In that instance, there is little to do except perhaps consider creating exempt transfers.

In summary, the SNT is a wonderful planning tool, but it is not a panacea. Other options should be discussed.

The pooled trust

The same federal legislation that created the SNT also created the pooled trust (PT). 42 USC 1396p (d)(4)(C) and OAR 461-145-0540(10)(b). The PT is basically a different type of special needs trust. As with an SNT, the transfer to, and the existence of, the PT will not disqualify the beneficiary from a needs-based public benefits program.

The statutes require that (1) the trust must be established and managed by a non-profit association, (2) the trust must be established by the parent, grandparent, legal guardian, certain individuals, or by a court [6], (3) the funds must be pooled with those of other beneficiaries (though separate accounts may be maintained for each beneficiary), (4) the beneficiary must be disabled under SSI criteria, and (5) on

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the death of the beneficiary, the remaining funds may be retained in the trust or paid back to the state up to the amount paid in benefits.[7]

These requirements, which are set out in both federal and state law, have some ambiguities. For practical purposes, the only PT in Oregon is the Oregon Special Needs Trust administered by The Arc of Oregon. Detailed information may be found at **www.arcoregon.org** or by calling the director, Mitch Teal, in Salem at 503.581.2726. The strength of the PT is its simplicity. The Oregon Special Needs Trust charges standard fees for its services and has an established protocol for trust distributions. The weakness of the PT is its inflexibility. For example, disbursements must be requested two weeks in advance, and disbursements of more than $1,000 are reviewed by a committee.

For more detail on the Pooled Trust see Lovelace, Renee Colwill, "Pooled Trusts: Opportunities and Risks," *The ElderLaw Report* (6/97).

Purchase exempt assets

Needs-based public benefits allow the beneficiary to own certain assets without interfering with eligibility. The most common are a home serving as a primary residence for the beneficiary, a vehicle used for the most nominal medical purposes or worth less than $4,500, and the contents of a home. OAR 461-145-0220, OAR 461-145-0360. Funeral and other final-arrangement plans may also be excluded. OAR 461-145-0040. Further, many beneficiaries suffer from what is euphemistically called "deferred consumption." They need furniture, music, a new TV, cell phone, etc. Funds may be applied to the purchase of these items without disqualifying the beneficiary.

In weighing particularly the purchase of a home, consider that in fact many disabled persons cannot manage a home. Ownership requires responsibility, effort, and decisions that are beyond the ken of some disabled folks. Similarly, many persons cannot or should not drive a vehicle. Finally, the amount of the settlement is critical in regard to large purchases that have ongoing maintenance and insurance expenses.

Creative spend-down

"Deferred consumption" meets its match in quickly and creatively spending money. Nothing in the rules prevents the spending of money on services. A vacation is a common desire and Disneyland a common destination. In addition, funds can be used for tuition, therapy, nonreimbursed medical expenses, experimental medical treatments, phone service, cable service, etc. The primary limitation is that funds cannot be spent to benefit another person or they become uncompensated transfers.

The chief disadvantage of creative spend-down is that it may take time to reach the eligibility amount and therefore there may be a period of ineligibility, which will vary from benefit to benefit. Generally, if the funds are spent in the same calendar month they were received, there will be no disqualification or the disqualification can be just one month. Of course, if there is a risk of a period of disqualification, funds to pay for ordinary expenses for that period must be available. These expenses can be prepaid.

Exempt transfers

Public-benefit programs have complicated rules regarding disqualification for the uncompensated transfer of assets (gifts). However, the law allows certain transfers without disqualification. For example, assets can be transferred to a blind, disabled, or minor child. OAR 461-140-0242(1)(b). A home may be transferred to siblings who have lived in the beneficiary's home and contributed to its equity or to adult children who have provided care for two years. OAR 461-140-0242(2). These rules are stated generally in federal law and crafted narrowly by the state in its rules. This means that the planner needs to carefully review the facts of a proposed transfer plan.

Forgoing public benefits

In rare circumstances a disabled person who receives substantial funds does not need to plan for public benefit eligibility. For example, the amount of money may be sufficient to pay for health insurance (assuming that the beneficiary is insurable), or a beneficiary may plan to marry a person of means, or the disability may be short-term and the beneficiary expects to be able to enter the workforce. The problem with taking the money in a form that disqualifies the person is that circumstances may change so that the person needs public benefits.

Conclusion

The SNT is the best means of protecting funds for disabled people who will be receiving funds that will disqualify them for needs-based public benefits. But the best SNT planning includes reviewing other options that may give the client a similar or better result. This is particularly true with smaller amounts of money. ■

Footnotes

1. The most common benefits are SSI, OHP, and OSIPM. Others include public housing and TANF. This article will not review the law of public benefits and is written for the practitioner who will research the particulars of the client's situation.
2. Further, the standard of practice could be said to mandate public benefit planning. See, for example, legal malpractice cases, *Janet Redies v. Attorneys Liability Protection Society, et al.*, S. Court of Montana, January 17, 2007 and *Rajcan v. Donald Garvey and Associates* (Ill. App. Ct. 2d, No 2-03-0270, April 5, 2004).
3. Interpreted in Oregon to mean a conservator. It is unclear whether a guardian ad litem would suffice.
4. In Oregon, this pay-back requirement was found to trump limitations on estate recovery in federal and state law. The case was a Multnomah County hearing on a petition for instructions. In California, a case came to the opposite conclusion.
5. Attorneys have been found liable for failing to bond and supervise a guardian of funds. *Janssen, et al, v. Topliff, et al* (Wash Ct. App., Div. III, No. 19786-7-III, Jan. 24, 2002) and *The Estate of Katherine M. Treadwell v. Kathleen M.S. Wright*, 115 Wash. App. 238, 61 P3d 1214 (2003).
6. Notice the contradiction as to who must establish the trust.
7. This last requirement, the pay-back provision, is currently in dispute in Oregon. DHS requires it but the federal law supports the proposition that funds may remain in trust for other PT beneficiaries.

Drafting joint trusts for the taxable estate

By Stephen J. Klarquist, Attoney at Law

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Joint revocable trusts—in which a married couple combines assets into a single trust—offer several advantages over separate trusts. Among the advantages are having one "pot" for assets, continued mutual ownership with full access by each spouse, the need for fewer brokerage and bank accounts, no decisions needed as to which trust pays which expenses, automatic equalization of assets for unified credit planning, and maintenance of community property. The primary disadvantage is the increased complexity and difficulty of drafting the trust. If recent discussions on the Estate Planning & Administration Section Internet discussion list are any indication, it appears that many practitioners have concluded that in most cases the advantages of using joint trusts far outweigh the disadvantages. Those inclined to use joint trusts, however, must be aware of the tax issues involved.

Avoiding tax pitfalls

Joint trusts of $1,000,000 and up require care in drafting to avoid unintended and adverse tax consequences. The major tax-related errors to avoid in drafting joint trusts are:

1. Drafting the trust so that unequal contributions by the spouses create inter-spousal gifts that fail to qualify for the marital deduction or that create completed gifts to remainder beneficiaries
2. Drafting the trust in a manner that creates completed gifts from the surviving spouse to the trust remainder beneficiaries at the death of the first spouse
3. Drafting the trust so that assets in which the surviving spouse has an ownership interest are used to fund a credit shelter trust, which results in the assets' inclusion in the surviving spouse's estate under IRC §2036

Error Number One: Failing to qualify for the marital deduction at formation

Assuming property has been contributed to the trust unequally by the two trustors, care must be taken to avoid a taxable gift from the spouse who contributes the greater share to the spouse who contributes the lesser share. One way to avoid making a gift is to maintain separate shares, with each spouse's share consisting of the property contributed by that spouse. However, it is often easier to maintain separate shares in theory than in practice. The assets may be commingled, exchanged, etc., or no records may have been kept, making attribution of the contributions impossible. How many times have you received a trust agreement prepared by another attorney with no list of assets attached?

To avoid this problem, the trust agreement can provide for equalization of shares, so that each trustor is deemed to own an equal share, resulting in a gift from one spouse to the other. To avoid adverse estate and gift tax consequences, either the gift must be incomplete or the gift must qualify for the marital deduction. The gift would be incomplete if the contributor retains the unilateral right to revoke the trust as to property contributed, but this would require the same record keeping that leads to problems with separate shares.

A better solution is to draft the trust so that gifts between the trustor spouses are complete and qualify for the marital deduction under §2523(e). This can be accomplished with some care and a few simple steps, and there is very little the *clients* can do to mess things up. Reg. §25.2523(e)-1(a) sets forth five requirements that must be satisfied:

1. The donee (noncontributing) spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.
2. The income must be payable annually or at more frequent intervals.
3. The donee spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.
4. The power in the donee spouse must be exercisable by him or her alone and (whether exercisable by will or during life) in all events.
5. The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the donee spouse.

These conditions are actually fairly easy to meet. The right to income (conditions 1 and 2) is satisfied if the spouse has the right to have the corpus—including accumulated income—distributed to him or her at any time. Reg. §25.2523(e)-1(f)(6) and (8). The power of appointment requirement (condition 3) is satisfied if the donee spouse has the power to appoint the assets to himself or herself at any

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time. Reg. §25.2523(e)-1(g)(1)(i). Condition 4 is satisfied if the power of appointment is not suspended or eliminated during periods of incapacity. Rev. Rul. 55-518, 1955-2 C.B. 384; Rev. Rul. 75-350, 1975-2 C.B. 367. To satisfy condition 5, the trustee must not be given any power in "opposition" to that of the donee spouse. A power in a trustee to distribute corpus to or for the benefit of the donee spouse will not disqualify the trust. Similarly, a power to distribute corpus to the spouse for support of minor children will not disqualify the trust if the spouse is legally obligated to support the children, nor will a power exercisable by someone other than the spouse only after the spouse's death. Reg. §25.2523(e)-1(h).

The "specific portion" language in conditions 1, 2, and 3 comes into play in determining whether the donee spouse's interest in a joint trust qualifies for the marital deduction. To qualify as a "specific portion," the rights of the donee spouse in income from his or her share of the trust, as well as powers of appointment over his or her share, must "constitute a fractional or percentage share of the entire property interest, so that the donee spouse's interest reflects its proportionate share of the increase or decrease in the value of the entire property interest to which the income rights and the power relate. Thus, if the spouse's right to income and the spouse's power extend to a specified fraction or percentage of the property, or its equivalent, the interest is in a specific portion of the property." Reg. §25.2523(e)-1(c)(2).

A gift from one spouse to the joint trust falls within this rule. The donee spouse must have an interest in the income and a power over the principal that extends to one-half (or other fraction) of the trust property. However, there is *no requirement that separate shares be established*. The separate share issue was put to rest with the enactment of the 1954 Tax Code, in which §2056(b)(5) and §2523(e) were enacted in essentially their current form. The changes made in 1954 added the "specific portion" language to the statute, to allow partial fractional interests in a trust to qualify for the marital deduction. *Stallworth's Estate v. Comm.*, 2 AFTR2d 6339; reversed on rehearing, 2 AFTR2d 6438 (1958).

The trust in *Stallworth's Estate* provided that if the spouse desired to withdraw her one-half share of the trust, then it would be divided into two "fairly equal" shares, after which she could choose which share she wanted. The wife qualified under the "specific portion" rule, even though the trust was not segregated into equal shares, and at her spouse's election to withdraw her share, the trust was to be divided on a non-pro rata basis.

Although the regulations under §2523(e) address the "specific portion" rule in some detail, they do not expressly address the non-pro rata share issue. Several examples in the regulations, however, indicate that a testamentary power to appoint one-half of the corpus as it exists at the time of the donee spouse's death would satisfy the power of appointment requirement as to one-half of the trust. See Reg. §25.2523(e)-1(c)(5), Examples (1) and (2); Reg. §25.2523(e)-1(h), Example (2).

In a closely related context, that of a partial QTIP election under §2523(f)(4), the same "specific portion" rule applies. The regulations provide that a partial election must relate to a "defined fraction or percentage of the entire trust ... or specific portion thereof *within the meaning of §25.2523(e)-1(c)*," referring back to the "specific portion" language in the very regulation under §2523(e) that is the subject of this discussion. Reg. §25.2523(f)-1(b)(3)(i). Reg. §25.2523(f)-1(b)(3)(ii) allows, but does not require, the division of a trust into separate shares if the governing document or local law allows such a division. This regulation clarifies that the "fractional or percentage" shares requirement does not mean a fractional or percentage share of each asset in the trust. Thus, the requirements of §2523(e) can be met if, in the case of revocation during life or division at death, the trust authorizes a division and distribution on an equal but non-pro rata basis, based on fair market values at the date of distribution.

In two cases involving a residuary bequest to a trust, the tax court and the Second Circuit held that the bequest qualified for the marital deduction to the extent of the surviving spouse's percentage or fractional interest in the trust as a whole. Presumably, each of the trusts was funded with the residuary assets of the estate in each case, and not solely with cash, but the issue was not discussed. *Gelb v. Comm.*, 298 F2d 544 (2nd Cir. 1962); *Estate of Hollingshead v. Comm.*, 70 TC 578 (1978).

The donee spouse's income and powers must extend to the "entire interest" or to a specific portion of the "entire interest." Each property interest in which the donee spouse receives some rights is considered separately in determining whether his or her rights extend to the entire interest or to a specific portion of the entire interest. Reg. §25.2523(e)-1(d). Caution should be exercised to avoid giving a donee spouse what amounts to a separate property interest in trust assets if his or her income interest and power of appointment do not extend to the same assets. For example, if the trust is set up so that each spouse "owns" an undivided one-half interest in *each* asset, each spouse's power of appointment should apply to an undivided one-half interest in each asset. On the other hand, if the agreement describes each spouse's ownership as one-half of the trust as a whole, then the power of appointment can extend to one-half of the value of the trust assets, but need not apply to one-half of each individual trust asset.

Consider a trust which gives each spouse:

1. a unilateral right to revoke the trust and to receive one-half of the trust assets in equal shares upon revocation, the make-up of which is to be determined by the trustees using date-of-division values, and
2. the right to direct the trustee to make distributions from income or principal to himself or herself in equal shares.

The agreement should provide that, in the

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event of incapacity, the trustees must make discretionary distributions in equal shares, and can make distributions for the benefit of (rather than directly to) the incapacitated spouse. Consider also giving each spouse the power to direct the trustee to make disproportionate distributions to the *other* spouse, i.e., a limited special power of appointment. This power could come into play, for example, if one spouse is ill and in a nursing home and has a greater need for income. The well spouse can direct the trustee to make disproportionate distributions to or for the benefit of the ill spouse. Neither spouse, however, should have the power either as trustor or as trustee to make disproportionately greater distributions to himself or herself.

This kind of trust perhaps comes closest to meeting the expectations of clients when they think of a "joint trust," and is the easiest for them to administer. No tracing of assets is required, no separate shares must be established, no accounting of distributions from separate shares is required, and there is no need to be concerned about equalizing ownership prior to funding. In short, it imposes no administrative responsibilities on the trustors or trustees that would have an impact on gift or estate tax matters. It does, however, require careful drafting, and a thorough consideration of the requirements of §2523.

Error Number Two: Drafting the trust in a manner that creates completed gifts from the surviving spouse to the trust remainder beneficiaries at the death of the first spouse

This error can take two forms. First, if the entire trust becomes irrevocable on the death of the first spouse, the surviving spouse is deemed to have made gifts of the remainder interests in the trust to the remainder beneficiaries after his or her interest has expired. This trap is easy to avoid by expressly providing that the surviving spouse's share remains revocable after the death of the first spouse, or by giving the surviving spouse a special power of appointment over the trust assets, thereby avoiding the completion of any gift to the remainder beneficiaries.

Second, if the surviving spouse's assets are used to fund the credit shelter trust, he or she has made a completed gift to the remainder beneficiaries. This problem is discussed in the next section.

Error Number Three: Drafting the trust so that assets in which the surviving spouse has an ownership interest are used to fund the credit shelter trust, with the result that the assets are included in the surviving spouse's estate under § 2036

Errors two and three primarily occur when the trust is drafted with ambiguous or inconsistent ownership provisions. Ambiguous ownership provisions are usually a result of sloppy drafting. A common example of this problem is a trust with language in one provision that apparently provides for two equal shares (such as saying that the trustors own the property "jointly"), and language in another provision that allows each spouse to withdraw his or her contributions. If property contributed by the surviving spouse is used to fund the credit shelter trust, the power in the surviving spouse to withdraw this property (pursuant to the latter provision) would be a §2038 power.

Careless record keeping or trust administration can also cause problems. For example, the trust may provide that each spouse separately owns separately contributed assets, and that jointly contributed assets are jointly owned or divided into two separate shares. Also assume that each spouse has the right to withdraw his or her own contributions. This kind of trust requires careful record keeping on the part of the trustors/trustees, and perhaps physical separation of the corpus into separate shares. After the death of the first trustor, the survivor may not be able to identify which assets belong to which share. The assets may have been so commingled that the surviving spouse (or advisors) can't tell which assets can be withdrawn from the trust and which cannot. If a determination cannot be made, the IRS may simply presume that the surviving spouse's assets were used to fund the credit shelter trust, absent evidence to the contrary.

A better approach is to give each spouse an undivided one-half interest in each asset. Each spouse may have the right to revoke the trust and to receive only his or her undivided one-half interest in each asset. Record keeping is eliminated or reduced because tracing is eliminated. The trust has two separate shares in theory, but actual division is avoided. Neither spouse can withdraw assets from his or her share alone. All distributions are deemed to come equally from both shares. At the death of the first spouse, his or her share is easy to identify because, by the terms of the trust, he or she owns an undivided one-half interest in each and every asset. As long as the assets in the deceased spouse's share are used to fund the credit shelter trust or disclaimer trust (or the proceeds from the sale or exchange of such assets), there is no basis for claiming that any of the deceased spouse's assets were used to fund the trust.

The disadvantage of this method is that funding the credit shelter trust or other bequests out of the deceased spouse's share must be made with undivided interests in property. For example, the couple's home may end up one-half in a credit shelter trust and one-half in a survivor's trust. There may be possibilities for tax-free swapping of assets between shares, but the inflexibility of this arrangement may produce a less-than-desirable result.

A third method of drafting a joint trust is to give each spouse a beneficial interest in one-half of the trust during their joint lifetimes. First, as described in the discussion of error number one, the trust provides that:

1. any income or principal distributed to the trustors, at the direction of either of them, will be distributed to them in equal shares,
2. either trustor, acting alone, has the right to revoke the trust in whole or in part, and

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3. in the event of revocation the trustees will distribute the trust assets to the trustors in equal shares, on a pro rata or non-pro rata basis.

Second, at the death of the first trustor, the trust is divided into equal shares for each trustor on a pro rata *or a non-pro rata basis*.

For income tax purposes, a non-pro rata division, authorized in the agreement, allows different assets to go into different shares without the recognition of gain or loss on the division. See PLR 200723014, which is the most recent ruling on this issue, and PLRs 9625020 and 8119040, distinguishing Rev. Rul. 69-486, 1969-2 CB 159. In the revenue ruling, the IRS stated, "Since the trustee was not authorized to make a non-pro rata distribution of property in kind…," the non–pro rata distribution was treated as a taxable exchange of assets. Note that the IRS specifically conditioned its adverse holding on the trustee's lack of authorization to make non-pro rata distributions.

Under §1014(b), the beneficiaries of the deceased spouse's estate should receive a stepped-up basis for the assets acquired from the decedent's share of the trust. In Rev. Rul. 69-486, cited in the paragraph above, because the trustee was not authorized to make a non-pro-rata division, the distribution was treated as distribution of an equal interest in each asset, followed by an exchange of assets. That is not the case where non-pro rata distributions are allowed. Where non-pro rata distributions are allowed, the step-up should not apply to one-half of each asset, but rather to assets distributed to the deceased spouse's share. Although the author has found no express authority for this, it seems to follow logically from a non-pro rata division.

A critical issue is whether a non-pro rata division after death creates any gift or estate tax problems. Assuming the donee spouse dies first, if the assets of the donee spouse's share are used to fund a credit shelter trust in which the donor spouse has an income interest or special power of appointment, does §§2036 or 2038 apply to bring the assets back into the estate of the donee spouse at death? In other words, are the assets traced back to the donor spouse for purposes of applying §§2036 or 2038?

The funding of the two shares at the death of the first spouse in effect creates two separate trusts, with each trust receiving assets of a value of one-half of the total value of the trust assets, and relinquishing ownership rights in the other half. If the trust were established by a third party, there is no doubt that, if authorized by the trust agreement or law, the trustee could make non-pro-rata distributions and that after such distributions each beneficiary would own no interest in the share of any other beneficiary. Consequently, there is no basis for concluding that the surviving spouse's assets were used to fund the credit shelter trust.

In several private-letter rulings, the IRS has held that a general power of appointment in the donee spouse prevents §2036 from applying to an income interest retained by the surviving donor spouse in the trust assets. PLR 9026036, PLR 8944009, and PLR 9109029.[1] The donee spouse's lifetime power of appointment over his or her share eliminates any application of §§2036 or 2038 to bring the assets back into the donor spouse's estate at his death. This is consistent with the fact that the donee spouse's interest in the trust qualifies for the gift tax marital deduction.

The real danger lies in not establishing separate shares at all, even after the death of the first spouse, and this is compounded if other provisions in the trust are ambiguous as to the beneficial ownership of assets. For example, assets contributed by the surviving spouse and which the surviving spouse could reclaim by revocation (e.g., by a trust provision that allows the contributor to reclaim contributed assets) should not be used to fund the credit shelter trust.

Planning Tips

Joint trusts may not be appropriate for second marriages, where joint, equal ownership of property would not be desirable. Each spouse in that situation may prefer to maintain separate ownership of property, and separate trusts would be better.

In some situations some assets *should* be divided on a pro rata basis or the ownership of a certain asset by one spouse or the other should be maintained—for example, where one spouse owns shares of a corporation or limited liability company or inherited assets. In this kind of situation, the trust should specifically state that the asset belongs to one spouse or the other, or that each spouse owns a specific number of shares, for all purposes. Another example might be where discounts are desired for fractional shares of real property.

The author usually names the "Survivor's Trust" (the share comprising the surviving spouse's assets after the death of the first spouse) the "[surviving spouse's name] Revocable Trust," so that if the surviving spouse later wants to amend it, he or she can just draw up a separate restated revocable trust with the same name, rather than attempt to amend the joint trust.

Medicaid issues obviously must be taken into account in certain cases.

Conclusion

Certainly, joint trusts carry tax risks aplenty for the inexperienced or careless drafter. But with careful drafting and both eyes on the tax code, the risks can be avoided. Joint trusts are not a vehicle for taxpayer abuse, and there is no reason the IRS should go out of its way to attack them (and it has not demonstrated any desire to do so), provided care is taken to ensure that the donee spouse's interest qualifies for the marital deduction, and that each spouse's ownership interest is carefully and consistently maintained. ■

Footnote

1. These rulings should be distinguished from some recent private letter rulings in which the deceased spouse held a power of appointment over not just his share, but over the surviving spouse's share as well, the purpose being to allow a credit shelter trust to be funded using assets from both spouses' shares of the trust, not just the deceased spouse's share. Although the IRS approved this arrangement, its reasoning has been criticized by commentators. See, for example, PLRs 200101021, 200403094, and 200604028.

Naming special needs trust as beneficiary of IRA can be good estate planning tool

By John H. Draneas and Mark L. Huglin, Attorneys at Law

John H. Draneas and Mark L. Huglin practice together at Draneas & Huglin, P.C. in Lake Oswego. Both are experienced tax and estate planning attorneys, and both are CPAs. John is a former Chair and Mark is the current Chair of the Oregon State Bar Tax Section.

Recent modifications to the tax rules regarding distributions make it possible to name a special needs trust as the beneficiary of an individual retirement account (IRA) or qualified plan. That creates a very useful tool for estate planning and elder law attorneys. To put icing on the cake, a recent IRS private ruling illustrates that it is even possible for the IRA distributions to go to a special needs trust created for the benefit of the disabled beneficiary after the death of the IRA owner.

Before getting into the explanation, a couple of caveats are in order:

1. Although the tax rules are the same for IRAs and qualified plans, the options may not always be the same, because one must comply with the requirements of the qualified plan. The plan document might limit the available forms of distribution. Otherwise, the discussion that follows regarding IRAs is equally applicable to qualified plans.
2. Naming a QTIP trust as the beneficiary of the IRA carries its own set of complications and challenges. The discussion that follows does not address QTIP trusts.

General rule for trust distributions

The general rule for distributions to a trust named as the beneficiary of the IRA turns on the age of the original owner of the IRA. If the owner died before the date of the first required minimum distribution, the entire IRA balance must be distributed no later than December 31 of the year that contains the fifth anniversary of the owner's death. IRC Treas. Reg. Section 1.401(a)(9)-3, A-2. Distributions can be made with any frequency, and no regular distributions are required. For example, if a person died on February 1, 2008, the trustee could wait until December 31, 2013 and then take a single distribution of the entire account balance.

If the IRA owner died after the date of the first required minimum distribution, the minimum distributions must be made in annual installments over the deceased IRA owner's single life expectancy immediately before death. IRC Treas. Reg. Section 1.401(a) (9)-5, A-5(a)(2). In most cases this will allow a longer deferral than the five-year rule. A person does not reach less than a five-year life expectancy under the tables until age 92.

See-through trust exception

The general rule requires that the distributions be made rather quickly. Because of the value of the tax deferral, it is usually better to defer the distributions as long as possible. Fortunately, a very broad exception for benefits payable to a "see-through trust" exists. If a trust qualifies as a see-through trust, the IRS will look through the trust and treat the beneficiaries of the trust as the beneficiaries of the IRA. Assuming all of the beneficiaries are individuals, distributions can be taken over the lifetime of the oldest beneficiary. Treas. Reg. Section 1.401(a)(9)-4 A-5(a).

It is quite simple for a trust to qualify as a see-through trust. There are only four requirements to be met:

1. The trust must be valid under state law. Treas. Reg. Section 1.401(a)(9)-4 A-5(b)(1).
2. The trust must be irrevocable. Treas. Reg. Section 1.401(a)(9)-4 A-5(b)(2).
3. The beneficiaries of the trust must be specifically identifiable individuals, not a class of persons. Treas. Reg. Section 1.401(a)(9)-4 A-5(b)(3).
4. By September 30 of the calendar year following the year of the owner's death, the trustee must provide the IRA custodian with either a copy of the trust document or the names of the beneficiaries—including contingent and remaindermen beneficiaries—and the condition of the beneficiaries' entitlements, including a certification that, to the best of the trustee's knowledge, this list is correct and complete and that the first three requirements have been met. Treas. Reg. Sections 1.401(a)(9)-4 A-5(b)(4) and 1.401(a)(9)-4 A-6(b).

Those are the only requirements. A see-through trust can be a simple trust or a complex trust, and it can have any special needs provisions the client desires. The distribution rules are only concerned with the timing of

Continued on page 9

Naming special needs trust as beneficiary of IRA *Continued from page 8*

the distributions from the IRA to the trust, not with how or when distributions are made from the trust to the beneficiary. Once the IRA distributions are made to the trust, the funds can be accumulated or distributed in any way.

Post-death creation of trust

In a very interesting recent private ruling, the IRS has even approved the creation of a special needs trust after the death of the owner of the IRA, ruling that the trust still qualified as a "see-through trust." PLR 200620025 dealt with a decedent who died at age 69, after naming his four sons as beneficiaries of his IRA. One of his sons was disabled and eligible for Medicaid. The decedent's spouse was the guardian for the disabled son. The IRA custodian set aside the shares of the other three brothers in separate sub-IRAs. The required minimum distributions were to be made to the disabled son from the original IRA.

The guardian filed a state court petition to create a special needs trust on behalf of the disabled son. The special needs trust provided that, on the death of the disabled son, the balance of the trust would be paid to the state Department of Children and Families to the extent necessary to satisfy the total medical assistance paid by the state on behalf of the disabled son, with any remaining balance paid to the disabled son's heirs. The guardian disclaimed her contingent remainder interest, and proposed to transfer the IRA to an IRA in the name of the special needs trust. The IRS approved the guardian's proposed plan, and ruled that the required minimum distributions could be calculated and paid over the life expectancy of the disabled son.

A private ruling is not precedent, but this one is still good news. This ruling not only clarifies that a special needs trust can qualify as a see-through trust but also indicates that the IRS is not opposed to creative post-mortem planning with respect to the creation of special needs trusts.

Obviously, it would have saved much effort on the part of the guardian if the special needs trust had been established ahead of time and the father had named it as the beneficiary of the IRA. If the father had done that, there would have been no need to provide that at the son's death the special needs trust would pay back the state for any benefits received by the son. Although the ruling does not address this particular point, it does appear there was no tax reason for this requirement. It was stated as a given regarding the terms of the special needs trust, and we assume that it was necessary only to enable the court to order the creation of the special needs trust. Because the benefits were initially payable directly to the beneficiary, the special needs trust would be viewed as having been funded with assets belonging to the beneficiary. Although this did not create any problems for income tax purposes, the SSI and Medicaid rules would require the payback. That would not have been the case if the parent had created and funded the special needs trust directly.

Conclusions

Naming a special needs trust as the beneficiary of an IRA is an excellent tool to use to fund the needs of a disabled beneficiary. The attorney should keep it in mind when advising a client on estate planning and not hesitate to suggest it if any of the client's beneficiaries suffers from a disability.

The attorney should also keep this technique in mind when administering the estate of a deceased client. Even if a special needs trust does not exist, it is still possible to create one after the fact, and to use the IRA to fund the special needs trust. Making this work, however, requires prompt action on the part of the attorney. The family must be advised about the strategy, and must not make any efforts to withdraw funds from the IRA before the special needs trust has been established. In addition, a tax attorney should be consulted to determine whether a private ruling should be requested. ■

Naming a special needs trust as the beneficiary of an IRA is an excellent tool to use to fund the needs of a disabled beneficiary.

New long term care insurance partnership program can protect assets of Medicaid recipients

By Joanne R. Schiedler, Oregon Department of Human Services, Seniors and People with Disabilities

Resources

Oregon administrative rule on LTC insurance partnership program: ***www.cbs.state.or.us/external/ins/lawsrules.html***

AARP Public Policy Institute report: ***www.aarp.org/research/longtermcare/insurance/fs124_ltc_06.html***

Web site for the New York State program: ***www.nyspltc.org***

The Department of Human Services (DHS) has partnered with the Oregon Insurance Division to implement a long term care (LTC) insurance partnership program in Oregon, effective January 1, 2008. OAR 836-052-0531.

The Deficit Reduction Act of 2005 gave states the option of implementing LTC insurance partnership programs, and Oregon received legislative authority to implement the program through Senate Bill 191 during the past legislative session. Under the program, an individual who purchases an LTC insurance policy designated as qualified partnership policy (QPP) will receive dollar-for-dollar resource protection in the event that the individual applies for Medicaid in the future. The individual receives this resource protection in two ways: first, in the Medicaid eligibility determination, and second, in the DHS estate recovery process after the individual passes away.

The amount of resource protection an individual receives depends on the total dollar amount of QPP payments the individual has received when he or she applies for Medicaid. For example, "Mary" purchases a QPP that pays $200 per day for 365 days for two years for a total of $146,000. After receiving these two years of QPP payments for care, Mary still needs care, so she applies for Medicaid. In the Medicaid eligibility determination, her resource limit would be $148,000: the usual $2,000 limit plus the $146,000 received from the QPP policy. Mary would be found eligible for Medicaid if her countable resources were within this much-higher resource limit. When Mary dies, DHS would have no claim on $146,000 of her estate. While on Medicaid, Mary could spend or give away the $146,000, and this would not result in a disqualifying transfer penalty. However, DHS would then have a claim on her remaining estate for the full amount of Medicaid benefits received.

This resource protection due to the receipt of QPP payments will be a great benefit both to individuals who have cash assets and to individuals who may simply want to protect their home equity from estate recovery.

There is one important caveat, however. Individuals who have home equity in excess of $500,000 and are ineligible for Medicaid under OAR 461-145-0220 cannot use QPP payments to reduce the countable home equity and become eligible.

Be aware, too, that this is a new form of insurance in Oregon, and an existing long term care policy likely is not a QPP. Insurance companies must file a long term care policy for approval for use as a partnership policy. any licensed Oregon agent who sells long term care insurance should be able to answer questions about a current policy and how to obtain a qualified policy.

Questions about the LTC insurance partnership program can be directed to the DHS Medicaid policy unit at 800.282.8096. ■

Council evaluates court procedures

Where do the Oregon Rules of Civil Procedure come from and how are they changed? If a particular rule is not effective or has been rendered obsolete by technology or practice, how may it be amended? The Council on Court Procedures was formed by the Legislature in 1977 to draft and to systematically update the Oregon Rules of Civil Procedure (ORCP). ORS 1.725 –1.760.

The group is composed of lawyers, judges, and at least one member of the public, and meets on the second Saturday of each month except July and August, usually at the Oregon State Bar.

The council addresses whether the Oregon Rules of Civil Procedure serve to fairly and efficiently resolve civil disputes for the benefit of parties and their attorneys. The council welcomes reports of instances where a rule is not, or is no longer, meeting the fair and efficient standard.

For details of what the council is at work on, go to its Web site at **www.lclark.edu/~ccp**. The current agendas and minutes are available and are searchable.

Questions may be addressed to the Council's Executive Director, Mark A. Peterson of the Lewis and Clark Legal Clinic. He can be reached at 1018 Board of Trade Building, 310 S.W. Fourth Avenue, Portland, Oregon 97204 or at 503.768.6500. ■

Agency and Professional Relations Subcommittee Report

DHS proposes changes in Medicaid estate recovery rules

By Michael Edgel, Chair, Elder Law Section APR Subcommittee

The Agency and Professional Relations Subcommittee of the Elder Law Section met January 15, 2008, with representatives from the Oregon Department of Human Services (DHS) and learned that the department is proposing significant changes to the Oregon Administrative Rules governing Medicaid estate recovery. Arguably the most important of these, from a planning standpoint, are the proposed changes to OAR 461-135-0832 and OAR 461-135-0835. If enacted, the changes will further expand the definition of "estate," and will make certain interspousal transfers of assets (most commonly, the transfer of a residence into the name of a community spouse) subject to the department's estate recovery process.

As written, the proposed rules will capture not only interspousal transfers that occur after the effective date of the rules (April 1, 2008), but also any such transfers that have occurred in the sixty months preceding an application for Medicaid. In short, the changes are retroactive, and are likely to affect clients who have transferred assets to a spouse over the last several years in reliance on current rules.

These changes represent a considerable departure from existing estate recovery practices, both in Oregon and nationally. Only two other states, North Dakota and Minnesota, have taken the approach proposed by DHS, and the department is relying in large part on judicial decisions from those states as authority for the changes.

The APR Subcommittee urges Section members to review the proposed changes carefully, and to submit written comments to the department before the February 26, 2008, deadline for public comment. The proposed changes can be viewed in their entirety at **www.dhs.state.or.us/policy/selfsufficiency/publications/01-15-08nprm.pdf** ■

Comments should be sent to:

Annette Tesch
Human Services Building

500 Summer St. NE E48

Salem, OR

97301-1066

Oregon Money Management Program offers help

By Carol Cookson, State Program Director, Oregon Money Management Program, Easter Seals Oregon

For some Oregonians who have a disability or have lost mental acuity, being able to pay bills and handle taxes and other financial tasks on time is more than they can manage. Many low-income, vulnerable individuals have no one in their lives able or appropriate to help them. The Oregon Money Management Program (OMMP) can provide a solution.

The OMMP, part of the AARP Foundation, helps vulnerable individuals maintain dignity and independence while protecting them from scams, financial exploitation, or simply very poor decisions. Trained and caring volunteers help participants manage debt, pay bills, budget, handle consumer problems, understand medical bills and insurance forms, and serve as representative payees for Social Security, VA, and other federal benefits. OMMP volunteers are recruited, trained, and supervised by local program sponsors—nonprofit community service organizations, social service agencies, religious organizations, legal and financial service organizations, and mental health programs. Because the OMMP is volunteer based, providing service is very cost effective. However, local sponsors need help from community partners to support program operations through in-kind and financial donations for office space, postage, program supervision, equipment, supplies, and volunteer recruitment, training, and recognition. The AARP Foundation insures participants from loss due to mistake or misuse by volunteers.

The program provides free help with basic financial tasks in Medford, The Dalles, and Douglas, Umatilla, Clackamas, and Lane counties. Easter Seals Oregon, which last June became the state coordinating agency for the OMMP, is developing new sponsors in order to expand service offerings throughout the state.

For more information about the OMMP, contact Carol Cookson, State Program Director, Easter Seals Oregon, by phone 503-552-9919 or email **mmp@or.easterseals.com**, or visit the national program Web site at **www.aarpmmp.org**. ■

Resources for elder law attorneys

Upcoming events

March 14, 2008
Veterans Law: Representing Former Service Members and Their Disability Claims
Oregon State Bar Center, Tigard
Ensuring proper and timely delivery of services to veterans and their surviving families is the focus of this new seminar offered by the Oregon State Bar.
www.osbarcle.org

March 14, 2008
Probate Primer &
The Latest in Probate Practice
Oregon Convention Center, Portland
Two Oregon Law Institute half-day programs designed to help you guide your client and your case through the probate process in as comprehensible and professional a manner as possible.
http://law.lclark.edu/org/oli

March 18, 2008
Estate Planning in 2008
World Trade Center, Portland
This two-hour Multnomah Bar Association seminar will cover the use of irrevocable life Insurance trusts and the selection of trustees in estate planning.
www.mbabar.org/register/programlist.php

April 18, 2008
Representing Elder Abuse Victims
Oregon Convention Center, Portland
This Oregon law Institute seminar will cover identifying elder abuse, obtaining a restraining order, getting a guardian or conservator appointed, and using the triple-damage elder abuse statute to recover damages. Participants will also learn about nursing home patients' rights and how to remedy abuse and neglect in long term care facilities.
http://law.lclark.edu/org/oli

May 9, 2008
OSB Elder Law Section unCLE program
Valley River Inn, Eugene
See box at right for details.

May 14–18, 2008
NAELA Symposium
Hyatt Regency Maui Resort, Kaanapali Beach
www.naela.org

Elder Law Section Web site

www.osbar.org/sections/elder/elderlaw.html

The Web site has useful links for elder law practitioners, past issues of the *Elder Law Newsletter,* and current elder law numbers.

Elder Law Section electronic discussion list

All members of the Elder Law Section are automatically signed up on the list, but your participation is not mandatory.

How to use the discussion list
Send a message to all members of the Elder Law Section distribution list by addressing it to: **eldlaw@lists.osbar.org**. Replies are directed by default to the sender of the message *only*. If you wish to send a reply to the entire list, you must change the address to: **eldlaw@lists.osbar.org,** or you can choose "Reply to all." ■

Popular unCLE program returns

By Mark M. Williams, unCLE Program Chair

The Elder Law Section is again sponsoring a unique program that gives elder law practitioners the opportunity to get together for a day-long session of brainstorming, networking, and the exchange of ideas and forms. The format for the sessions will be small group discussions with topics moderated by elder law attorneys willing to share their experiences. There will be no formal speakers, but there will be time to question and learn from our peers. The program is modeled on the highly successful NAELA UnProgram, and this is fourth time for our local version. The program has received very high ratings from attendees, many of whom think it's the best educational opportunity available. Despite its title, the Oregon State Bar approved 4.0 general credits and 1.0 ethics credit for the 2007 unCLE conference.

The program will be held on Friday, May 9, 2007, from 8:00 a.m. to 5:00 p.m., at the Valley River Inn, 1000 Valley River Way, Eugene, Oregon. It is designed to get us away from our practices for a full day and to allow colleagues from parts of the state to have reasonable access.

Attendance is limited to 75 Elder Law Section members, so register early. Last year the program sold out. Registration is $100, and includes a full buffet breakfast, lunch, and post-program reception. Add $25 for Section dues if you are not already a member.

Register by contacting the Oregon State Bar order desk at 800.452.8260, ext. 413 or 503.684.7413.

Do not miss this chance to mix and mingle with your peers in the elder law community and discuss substantive issues as well as nuts-and-bolts practice issues. ■

Important elder law numbers

as of January 1, 2008

Supplemental Security Income (SSI) Benefit Standards	Eligible individual	$637/month
	Eligible couple	$956/month
Medicaid (Oregon)	Long term care income cap	$1,911/month
	Community spouse minimum resource standard	$20,880
	Community spouse maximum resource standard	$104,400
	Community spouse minimum and maximum monthly allowance standards	$1,712/month; $2,541/month
	Excess shelter allowance	Amount above $514/month
	Food stamp utility allowance used to figure excess shelter allowance	$303/month
	Personal needs allowance in nursing home	$30/month
	Personal needs allowance in community-based care	$144/month
	Room & board rate for community-based care facilities	$494.70/month
	OSIP maintenance standard for person receiving in-home services	$638.70
	Average private pay rate for calculating ineligibility for applications made on or after October 1, 2006	$5,360/month
Medicare	Part B premium	$96.40/month*
	Part B deductible	$135/year
	Part A hospital deductible per spell of illness	$1,024
	Part D premium: Varies according to plan chosen	average is $27.35/month
	Skilled nursing facility co-insurance for days 21-100	$128/day

* A person whose income is more than $82,000/year will pay a higher premium

Tax returns required for economic stimulus checks

All recipients of Social Security benefits must file 2007 income tax returns to claim the income tax rebates that are part of the federal government's economic stimulus package. The IRS estimates there are approximately 20 million Social Security beneficiaries who would not normally file a tax return for 2007, but will now need to do so to receive a stimulus payment.

Some beneficiaries may have discarded their 1099 form. They do not need a replacement 1099, because the IRS will accept an estimate of Social Security benefits received in 2007 in line 14A of the 1040A.

It appears that the payments will not be counted as income for Medicaid, SSI, and other public benefit programs funded in whole or in part by the federal government. ■