Supplemental Needs Trusts and Nursing Home Planning

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Many families want to protect assets from nursing home expenses. This concern becomes acute when there are children[1] with special needs. This article discusses strategies that can be used to protect assets, starting with a discussion of some nursing home terminology, then highlighting the power of advance planning, and concluding with a discussion of how some protective trusts can be set up for children with disabilities and how these trusts can be woven into the estate plan when families are trying to protect assets from nursing home costs.

FIVE-YEAR "LOOKBACK"

Generally, strategies can be distinguished by whether the planning was done *ahead* of the lookback period or *within* the lookback period. So, what is the "lookback" period? Most people have heard of the five-year lookback period for nursing home care[2], but do not know exactly how it applies. It applies when one needs Medicaid funding to pay for nursing home bills. At that time, a Medicaid application is filed asking the state for help. To process the application, up to five years' worth of financial statements may be reviewed. If disqualifying gifts have been made within the five-year period, then the state will apply a "penalty period" measured by the amount given away. During the penalty period, the state will not help with medical costs, which is devastating.

Simply put, the laws prevent a person from giving his or her assets away one day and getting state help with a nursing home bill the next.

PRE-CRISIS PLANNING

The most effective planning is done well before a crisis occurs. A typical strategy involves creating and funding an irrevocable trust five years before an application for Medicaid is filed. This strategy, although very useful, is not perfect, and some resist doing this because there is an inherent loss of control over assets put inside the trust[3]. This reluctance to plan in advance can become an impediment to effective planning.

CRISIS PLANNING

If one's health declines precipitously and assets are at risk of being spent down on long-term care, there are still options. For instance, married couples may consider wills that contain "testamentary" trusts[4]. These are specialized wills used for married couples. When the "first" spouse dies, assets passing under the deceased spouse's will flow into a trust for the surviving spouse. This trust protects assets within it *without the five-year lookback* constraints. Of course, this strategy has limits because (1) a spouse must pass away for the plan to work, and (2) in most instances, it is tough to predict which spouse will pass away first[5]. Other crisis strategies include spend-downs, last-minute gifts combined with promissory notes to save some, but not all, of the assets (for Rhode Island residents), and specialized annuities[6]. These crisis strategies are very helpful, yet they are not perfect.

SUPPLEMENTAL NEEDS TRUSTS OVERVIEW

Federal and state laws provide protections for children with disabilities. One of the most important strategies is a supplemental needs trust[7]. Supplemental needs trusts *stretch out* assets for a child's care. Without such trusts, assets left directly to a child on a means-tested public benefits program (like SSI or Medicaid) cause the child to lose benefits. And those lost benefits remain unavailable until the child has spent down assets to a pittance, at which point the child can reapply for benefits. This result is nothing short of a disaster, as the assets help the state as opposed to the child. This problem can be avoided with a supplemental needs trust.

There are two broad categories of supplemental needs trusts; one that *must*, upon the child's death, reimburse the state for care provided during the child's lifetime, and one that *does not*

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1 *In this article, "children" or "child" refers to relationship as opposed to age. For instance, "my child" could refer to a small child or an adult child.*

2 *When "nursing home" care is mentioned in this article it is a generic reference to the long-term-care agencies that pay for care in a nursing home. This would be "MassHealth" for our Massachusetts clients and "DHS" for our Rhode Island clients.*

3 *Valuable protections can nonetheless be built into the trust to retain "income" and the right to "occupy" property.*

4 *A "testamentary" trust begins upon a person's death, as opposed to being created while a person is living (a "living" trust).*

5 *Typically, assets are titled one-half in one spouse's name, and one-half in the other spouse's name, with the idea that if one spouse dies (whoever it is), at least some assets will be protected. Thus this "fallback" strategy is not always perfect because by its nature it protects only a portion of the assets.*

6 *Some annuities can be used as a spend-down for married couples where one spouse enters the nursing home and the couple has "too many assets."*

7 *"Supplemental" needs trust is synonymous with "special" needs trust.*

have to reimburse the state (so assets go back to the family).

Trusts that have the "payback" requirement can be further categorized as "first-party" supplemental needs trusts, and "pooled" trusts[8].

Trusts that do not have the payback requirement are called "third-party" supplemental needs trusts.

Understanding this, one may ask why anyone would ever *want* to establish a trust that pays assets to the state upon the child's death. The answer is, sometimes it's the only option. The first situation would be when the assets are the child's. When the assets to be protected *come from the child*, a payback supplemental needs trust is required. So, instead of requiring the child to spend down all of his or her assets, and then forcing the child to live entirely off a (minimal) stipend from Social Security, the laws allow a child to receive the benefit stipend and *supplement* it with his or her assets that have been placed in the supplemental needs trust. This can have extraordinarily beneficial results for the child, as it improves the child's quality of life.

The second situation when a payback-type supplemental needs trust might be used is when a *parent is sick* and cannot wait out the five-year lookback period, but still wants to protect assets.

Our crisis planning might entail having the parent, before entering the nursing home, transfer assets into a supplemental needs trust with a *payback provision*. There is an exceptionally valuable carve-out in the law that allows a parent to transfer assets to a supplemental needs trust (with a payback provision) *without a corresponding penalty for gifts made within the five-year lookback period*. Some quick examples below show how profound this can be:

> *Example 1.* Susan Smith is 80 years old, and her health is rapidly declining. She is the surviving parent of Peter Smith. Peter is 60 years old and has had a disability since birth. Susan's primary goal is to maximize what is left to Peter, and she wants to know if it is too late to protect her assets from being spent down on the nursing home care. In this situation, Susan could establish and transfer assets into a "first-party" supplemental needs trust (that contains a payback provision to the state) for Peter that would help him for the duration of his life. Even though Susan would be transferring assets within the five-year lookback period, *there would be no penalty*. Assets transferred into Peter's supplemental needs trust would benefit Peter, and upon *Peter's* death any remaining assets in the trust would be paid back to the state for benefits provided to Peter during his lifetime.
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> *Example 2.* Assume the same facts above, except in this example Susan has suffered a stroke and has become incompetent, with a prognosis of an extended nursing home stay. In this second example, Susan's appointed "agent" under her power of attorney could create the "first-party" supplemental needs trust (with a payback provision) for Peter, and Susan's assets could be transferred into it, thereby protecting the assets for Peter's lifetime until his death[9].

Wrapping this all together, we might instruct a healthy client who wants to (1) protect assets from nursing home costs and (2) preserve assets for a child with a disability to set up an irrevocable third-party supplemental needs trust (which does not have to pay the state back upon the child's death). If this is done five years prior to the *parent's* nursing home crisis, the assets placed in the supplemental needs trust should be insulated from the parent's nursing home costs and *remain protected* for the child with a disability, enhancing the child's quality of life until the child deceases, at which point assets remaining would pass back to family members free of any claim by the state. Alternatively, if the declining health of a parent prevents this optimal planning from working, we could still instruct the client on how to protect assets from the nursing home and protect such assets for the child's lifetime, subject to the payback requirement[10].

SUMMARY

Supplemental needs trusts offer important solutions for families who have children with disabilities. Families who plan well in advance can achieve asset protection from nursing home costs and for their children without diminution of the assets upon the child's death. Families who have not planned well in advance still have powerful planning options to protect property from the high costs of nursing home care. If you have a child with a disability, please (1) consider, if you have not done so already, creating and possibly funding a third-party supplemental needs trust that does not contain payback provisions, (2) consider preparing and nominally funding a first-party supplemental needs trust that does have payback provisions, to be on "standby" to receive assets in a crisis and (3) make sure your power of attorney is up to date and contains the specialized language needed to create these helpful trusts in a crisis. **FT**

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[8] *Both "first party" supplemental needs trusts and "pooled" trusts are typically funded with the child's own assets, but a major distinction between the two types of trusts is how they are administered. A first-party trust is private, whereas with a pooled trust, assets are combined and managed collectively with other children's assets.*

[9] *There are some good lessons in these examples. First, it shows the value of creating and funding a third-party supplemental trust well ahead of time (to avoid the requirement of a "payback"). Second, it shows how important it is to have a well-prepared power of attorney that allows the creating and funding of these specialized trusts even if one has lost capacity. Third, some clients may wish to prepare and nominally fund a first-party supplemental needs trust (with a payback provision) ahead of time, so that it is on "standby" and ready to be used immediately if a crisis presents itself.*

[10] *This payback requirement is a strong incentive to plan ahead of time, as assets transferred in advance of a crisis do not have to be paid back to the state.*

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