Is it safe to leave an inheritance to a disabled child through a revocable inter vivos trust?

By Jonathan A. Levy

Revocable inter vivos trusts, also known as living trusts, are a popular will substitute. These trusts can avoid probate and assure continued management of the assets of a grantor who becomes incapacitated. In other cases, parents of a disabled child often wish to leave the child's inheritance in a discretionary special needs trust that preserves the child's Medicaid eligibility. Until recently, most lawyers believed that the inter vivos trust and the discretionary special needs trust could be combined into a revocable trust with the child's share retained in a special needs trust after the parent died. However, some Oregon elder lawyers now suggest that the only safe way to qualify a child's inheritance for Medicaid is through a *testamentary* special needs trust. Their caution is based on anecdotal reports that some caseworkers view inter vivos special needs trusts as "available"assets under the Medicaid rules.

This article is intended to encourage elder lawyers not to abandon inter vivos special needs trusts to meet the mistaken concerns of some caseworkers. As the following points show, an inheritance left by a parent to a disabled child[1] through a properly-drafted[2] inter vivos special needs trust, is not an available asset under established principles of Medicaid law.

The case for the revocable inter vivos trust

- Courts in other states have ruled that inheritances left to disabled children through inter vivos special needs trusts are not available assets for Medicaid purposes.[3] I am aware of no reported decision to the contrary.
- Leading commentators have recognized that special needs trusts for disabled children may be established either by will or through inter vivos trusts.[4]
- The general rule in Oregon is that income and resources are "available" to a Medicaid applicant only if he or she has a legal right to compel distribution.[5] This Oregon rule is mandated by federal law.[6] In addition, Oregon regulations specifically provide that assets of an irrevocable or restricted trust are not available if they cannot be used to meet the basic monthly needs of the child's household.[7]
- Additional Medicaid rules apply in Oregon to trusts established on or after October 1, 1993.[8] Notably, under OAR 461-145-0540(5), a trust is considered to have been established by the applicant—thus potentially triggering a transfer-of-assets period of ineligibility—if (i) the "financial group" (essentially, the benefit recipient and his or her spouse and children[9]) "used their resources" to establish the trust and (ii) the trust was established by, or on behalf of, the applicant "other than by will." This *other than by will* phrase has apparently led some caseworkers to conclude that inter vivos special needs trusts, funded by third parties, are available assets. But the conclusion ignores the preceding phrase: "used their resources." Inheritances from inter vivos special needs trusts are funded with the assets of the grantor parent, not the beneficiary child (or the child's financial group). OAR 461-145-0540(5) simply does not apply here.
- OAR 461-145-0540(5) and its related rules were prompted by the Omnibus Budget Reconciliation Act of 1993 (OBRA), which amended federal Medicaid law. The text and legislative history of OBRA also make clear that the post-1993 rules apply only to trusts funded at least in part with an applicant's own assets.[10]
- In its Social Security manual, the U.S. Department of Health and Human Services has determined that trust principal is not "available" to a recipient who is a beneficiary of a third-party trust without the legal right to demand disbursements or to direct the use of the trust assets.[11]

In conclusion, lawyers should recall what the U.S. Supreme Court has written about the availability principle: it "serve[s] primarily to prevent the States from conjuring fictional sources of income and resources by imputing financial support from persons who have no obligation to furnish it or by overvaluing assets in a manner that attributes nonexistent resources to recipients."[12] The

Continued on page 14

Jonathan A. Levy is a partner of Cavanaugh Levy Twist LLP in Portland. His practice emphasizes estate planning and administration, elder law, and planning for retirement benefits. He is a member of the executive committee of the Estate Planning and Administration Section.

Publications about Special Needs Trusts

Steve Dale, Esq., "Designating a Special Needs Trust: A Three Step Approach to Maintain Benefits and Reduce Taxes," *NAELA Quarterly*, Spring 2002.

G. Mark Shalloway, CELA, "Selecting and Advising Trustees of Special Needs Trusts," *NAELA Quarterly*, Spring 2002.

Roger M. Bernstein, Esq., LLM, "Special Needs Trust: Administration and Compliance," *NAELA Quarterly*, Summer 2001.

Robert Fleming, CELA, and Stuart Morris, CELA, "Taxation of Special Needs Trusts," *NAELA Quarterly*, Summer 2001.

Cynthia L. Barrett, "The Taxation of Special Needs Trusts: Considerations for Trustees," *The ElderLaw Report*, Vol. XII, Number 8, March, 2001.

Donna R. Meyer and Wesley D. Fitzwater, "Special Needs Trusts: Working with a Disabled Beneficiary," *Administering Trusts in Oregon*. Oregon State Bar CLE, October 19, 2000.

Wesley Fitzwater and Richard Pagnano, "Special Needs Trusts," Oregon State Bar looseleaf publication, *Administering Trusts in Oregon.*

List courtesy of Donna R. Meyer

Challenge to LTC cutbacks scheduled for hearings

A preliminary injunction hearing was set for June 12 in Federal District Court in Portland in a legal challenge to the State's termination of Medicaid service payments to low income individuals who live in 24-hour care settings. Legal Aid Services of Oregon, the Oregon Law Center, Lane County Law and Advocacy Center, and the National Senior Citizens Law Center filed the case, alleging that the termination of the services violates federal Medicaid law. The termination of Medicaid service payments was a part of the wave of budget cutting measures taken by the legislature and state agencies earlier this year to balance the 2001-03 budget.

A hearing set for summary judgments will take place on July 28.

Providing for child through revocable inter vivos trust

Continued from page 9

specter that some caseworkers might overlook this principle is not a sound reason to limit inheritances for disabled children to testamentary special needs trusts. To do so will unnecessarily deprive many clients and their families of the benefits of revocable inter vivos trusts.

Footnotes

1. This article does not cover gifts in trust between spouses or from a parent to a child while the parent has a legal duty to support the child. In these settings, the eligibility rules are more restrictive and the case for using a testamentary trust is more compelling.
2. This article assumes that the trust is properly drafted with a distribution standard that causes trust assets to be deemed unavailable to the beneficiary. For detailed treatments of drafting issues, see Clifton Kruse, *Third-Party and Self-Created Trusts*, ch. 3 (3d ed. 2002); Donna Meyer, "Special Needs Trusts: Recent Changes and Common Conundrums," in *Problem Prevention in Elder Law*, 5A-6 to 5A-12 (OSB CLE 2001).
3. E.g., *Matter of Leona Carlisle Trust*, 498 N.W.2d 260 (Minn. App. 1993); *Hecker v. Stark County Social Service Bd.*, 527 N.W.2d 226 (N.D. 1994).
4. Kruse, *supra* note 2, at 52; Lawrence Frolick & Melissa Brown, *Advising the Elderly or Disabled Client*, ¶ 17.06[2][c][ii] (2d ed. 2003); Sterling Ross, "The Special Needs Trust: A New Wrinkle No More," *Heckerling Institute on Estate Planning* ¶ 1602.2 (2002); see also John Regan, Rebecca Morgan, & David English, *Tax, Estate & Financial Planning for the Elderly* § 10.13[1] (2002) ("Special needs trusts created by third parties from their own assets are not affected by OBRA 1993 and remain valid to the extent that they are recognized by state law.")
5. See ORS 414.025; 414.038-414.042; see ORS 413.005(3) & (4); OAR 461-140-0020(1) & (2); OAR 461-140-0040.
6. 42 U.S.C. §1396a(a)(17)((B) (state may take into account only income and resources that are "available" according to standards prescribed by federal regulations); see 20 C.F.R. §416.1201(a)(1) (resource is unavailable for Social Security purposes if individual cannot liquidate it or convert it to cash); ORS 409.040 (federal Medicaid law supersedes contrary Oregon law).
7. OAR 461-140-0020(2)(e); OAR 461-145-540(2)(b).
8. See OAR 461-145-0540(4) - (11).
9. See OAR 461-110-530 (defining "financial group").
10. See *H.R. Conf. Rep. No. 103-213, 103rd Cong., 1st Sess. 834* (1993), reprinted in 1993 U.S.C.C.A.N. 1088, 1523; *Skindzier v. Com'r of Social Services*, 784 A.2d 323, 330-31 (Conn. 2001); Kruse, *supra* note 2, chs. 1-3; HCFA State Medicaid Manual, Part 3 – Eligibility, HCFA Transmittal No. 64 §§ 3259.2 – 3259.4 (Nov. 1994) (post-1993 trust restrictions apply only to the extent trust assets are attributable to the applicant).
11. See Programs Operation Manual System (POMS) SI 01120.200.D.
12. *Heckler v. Turner*, 470 U.S. 184, 200 (1985).