# *OBRA-93 TRUST OPTIONS FOR PERSONS WITH DISABILITIES*

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Families who have a loved one with a disability have unique financial and estate planning needs. Parents are frequently concerned about who will look after their child with a disability if they, themselves, become disabled. Families further question who will care for their loved one after they are gone. Fortunately, families are learning that trusts exist which can provide for the special needs of a loved one while preserving eligibility for various governmental benefits and services.

The Special Needs Trust, also commonly known as the Supplemental Needs Trust or the Supplemental Care Trust, is created and funded by someone other than the person with a disability (the Grantor). The Grantor decides to whom the Trust assets will be distributed (the contingent beneficiaries) upon the death of the primary beneficiary (the loved one with a disability). Therefore, the Special Needs Trust is a valuable estate planning tool for families who wish to leave money to their loved one without endangering eligibility for essential benefits and services.[1]

However, this type of trust differs from the self-settled trusts discussed below because the primary beneficiary may not place his own assets (for example, from an inheritance or personal injury settlement) into the Special Needs Trust without jeopardizing his governmental benefits. This prohibition stems from the general rule that a person should not be able to shelter his assets from his creditors by placing them into a trust over which he has no control, but of which he is a beneficiary.[2]

However, Congress has carved out somewhat of an exception to this rule through the enactment of the Omnibus Budget Reconciliation Act of 1993 ("OBRA-93").[3]

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[1] Special Needs Trusts are not the focus of this article; however, they warrant some discussion for comparison purposes. See Joel S. Welber, *The Use of Trusts to Compliment Essential Benefits in Residential-Life Care Planning*, 75 Mich BJ 402 (May 1996) for a more thorough discussion of the Special Needs Trust.
[2] §156 of the Restatement of the Law of Trusts Second
[3] 42 USC 1396p

Within OBRA-93, Congress allows for the creation of two types of trusts which may be funded with the assets of the person with a disability herself. These trusts are intended to balance the recognized needs of persons with disabilities with the government's right to require citizens to be individually responsible for their own medical care.[4] Most importantly, these trusts are exempt from the eligibility rules which generally govern trusts and should not adversely affect a Medicaid applicant.

The first of these trusts is the Exception A Trust. The second is the Exception C Trust. The purpose of this article is to provide a general overview of these planning possibilities and to outline when they should be considered.

An Exception A Trust, which is also known as a payback trust, an OBRA-93 Special Needs Trust or a (d)(4)(A) Trust, is "[a] trust containing the assets of an individual under age 65 who is disabled (as defined in Sec. 1614(a)(3)) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual or court if the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan under this title."[5]

That is, the assets of an individual with a disability (under the age of 65) can be placed into a Trust and the existence of said Trust will not affect the individual's eligibility for various governmental benefits and services. Like the Special Needs Trust outlined above, during the individual's life, the Trust provides for his special needs. However, unlike the Special Needs Trust, the Exception A Trust directs the Trustee, upon the death of the individual, to reimburse the State for whatever medical assistance has been paid. The trust assets remaining after such reimbursement, if any, will then be distributed to contingent beneficiaries named within the Trust.

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[4] Estate of Eubanks, Kings Co., Sur., NYLJ (5/24/95), p. 31, col. 4.

[5] 42 USC 1396p(d)(4)(A). A person is "disabled" if he "is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuos period of not less than 12 months (or, in the case of a child under the age of 18, if he suffers from any medically determinable physical or mental impairment of comparable severity)." Social Security Act § 1614(a)(3)(A)

An Exception A Trust can be funded with the well-intentioned but unfortunately destructive inheritance that a person with a disability has received directly from a family member. It can also be funded with money already received by an individual with a disability as the result of a personal injury, medical malpractice or automobile negligence suit/settlement.[6]

The creation of an Exception A Trust in any of these circumstances allows a person with a disability to use trust assets to supplement his benefits and services during his life, while providing for reimbursement to the State upon his death. However, reimbursement is capped by the amount remaining in trust at the person's death. Therefore, if the Trust has been exhausted during the person's lifetime, the State will receive nothing.

The State of Michigan, through the Family Independence Agency, now the Department of Community Health, and the Federal Government, through the Social Security Administration, have challenged many of these Trusts. Ironically, they often base their attacks on Trust language which is identical to wording found in other, previously-drafted and unchallenged Exception A Trusts. Therefore, be forewarned that anyone who chooses to create Exception A Trust may have to bear the additional expense of defending the validity of the said Trust. Overall, however, these Trusts have been a successful tool for the insulation of assets of persons with disabilities during their lifetimes.

Turning to the second of the two Trusts allowed by Congress, an Exception C Trust, also known as the Pooled Accounts Trust, Pooled Income Trust, the Pay to Charity Trust or the (d)(4)(C) Trust,[7] is defined as follows:

> A trust containing the assets of an individual who is disabled (as defined in section 1614(a)(3)) that meets the following conditions: (i) The trust is established and managed by a non-profit association, (ii) A separate account is maintained for each beneficiary of the trust, but, for purposes of investment and management of

[6] Structuring one's settlement correctly before any monies have been received is critical.
[7] Michigan's Family Independence Agency's Program Eligibility Manual Item 401 refers to this Trust as an "Exception B Trust."

> funds, the trust pools these accounts. (iii) Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in Sec. 1614(a)(3)) by the parent, grandparent or legal guardian of such individuals, by such individuals, or by a court. (iv) To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this title.[8]

Both Exception A and Exception C Trusts require reimbursement to the State for payments it has made on behalf of the deceased primary beneficiary before any trust assets can be paid to Trust's contingent beneficiaries. However, with the Exception C Trust, the State will not be reimbursed to the extent that funds remain in the Trust after the death of the primary beneficiary. Therefore, if a non-profit organization, which is managing an Exception C Trust, retains the assets contained in an account for people with disabilities upon the death of the beneficiary (the Trust must specifically allow for such retention), it can then use said assets for the benefit of others with disabilities and the State will be forced to take nothing. The beneficiary may be able to indicate another family member with a disability to benefit from the funds remaining, or that the funds be used for a person receiving assistance from another disability organization.

Other differences exist between Exception A and Exception C Trusts. Although an Exception A Trust is only available to individuals under the age of 65, the Exception C Trust has no such age limitation. Further, while a person with a disability can establish her own Exception C Trust account, she is barred from creating her own Exception A Trust (the latter must be done her behalf by a parent, grandparent, legal guardian or by the court).

Unlike the Exception C Trust, pooled income funds have been in existence for some time. Since the enactment of Section 642(c)(5) as part of Tax Reform Act of 1969,[9] this type of Trust has become a popular fund-raising technique of non-profit

[8] 42 USC 1396p(d)(4)(C). See footnote 6 for the definition of "disabled."
[9] 26 USC § 642(c)(5)

organizations.[10] Pooled income funds provide income for life to their beneficiaries while the managing non-profit organization retains the principal contributed by said beneficiaries (or their families). Specifically, each beneficiary makes a contribution to the fund. The non-profit is then allowed to pool the contributions of several beneficiaries for the purposes of investing the funds. Each beneficiary receives all income resulting from his/her original contribution to the fund, but upon his/her death, the principal must be paid to the non-profit organization.

In response to their popularity, prior to its enactment, the Arc, US strenuously advocated for the inclusion of an *exempt* pooled income fund within OBRA-93. If successful, a person could be the beneficiary of such a fund without affecting his eligibility for benefits. Speculation exists that through the creation of the Exception C Trust, Congress did in fact intend to grant exempt status to these popular pooled income funds.

An Exception C Trust does not necessarily have to be a pooled income fund as defined by the Tax Reform Act of 1969.[11] However, there are several advantages to making an Exception C Trust a pooled income fund: (1) the IRS has published an approved declaration of trust form;[12] (2) a donor (the person contributing money to the fund) receives an income tax charitable deduction based on (a) the value of the property contributed to the fund, (b) the type of property contributed, and (c) the value of the irrevocable remainder interest contributed to the charitable beneficiary. Therefore, not only does the usage of an Exception C Trust allow for the insulation of assets and eligibility preservation, it can potentially provide the donor with the above-outlined tax benefits.

The primary purpose of an Exception C Trust, which is not a pooled income fund, is to provide another planning option for people with disabilities to maintain their eligibility for governmental benefits and services (rather than tax benefits). Therefore, a

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[10] John H. Clymer, *Pooled Income Funds: A Good Vehicle for Smaller Charitable Gifts*, Estate Planning, vol. 24, no. 7, pp. 310 – 317 (Aug/Sept 1997)
[11] 26 USC § 642(c)(5)
[12] Rev. Proc. 88-53, 1988 – 2 C.B. 712

non-profit organization may establish an Exception C Trust which differs from a pooled income fund. For example, an Exception C Trust may benefit its beneficiaries through the use of both income and principal. Obviously, this type of Trust is much more desirable for the beneficiary.

I have drafted five Exception C Trusts in Michigan. These Trust Agreements have been approved by the State of Michigan's Medicaid office and the Social Security Administration, and the establishment of accounts within the Trust should go unchallenged.

They are clearly a valuable alternative to the Exception A Trust. Further, as outlined above, an Exception C Trust may be a viable planning option in certain circumstances where the creation of an Exception A Trust is prohibited.

An Exception C Trust is particularly useful when: (1) a family with a small to mid-size estate has no contingent beneficiaries in mind; (2) a family with a small to mid-size estate cannot find a Trustee; (3) an individual with a disability wishes to open his own account in order to accumulate/save more that $2,000.00 in non-exempt assets; and (4) a person wants to use the OBRA-93 exempt transfer rule to qualify for Medicaid.

In conclusion, a variety of trusts continue to be useful *and legal*[13] planning tools for persons with disabilities and their families. Unfortunately, this area of law remains largely misunderstood and under-used by families, attorneys and the makers of public policy. As challenges to the long-term care system loom in Michigan's near future, the usage of these trusts will become increasingly important as a way to forge valuable private partnerships between families, people with disabilities and the public mental health system that serves them.

[13] Section 217 of the Health Insurance Portability and Accountability Act (commonly referred to as the Kennedy/Kassenbaum legislation), as amended by 42 USC § 1320a-7b(a)(6) (the Balanced Budget Act of 1997) attempts to impose criminal penalties on Medicaid planning.