

# The ElderLaw Report

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## Advanced Medicaid Planning III: Trusts

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Trusts continue to be significant in making provision for community spouses and others. Many planning issues have arisen, including the impact of the Medicaid Qualifying Trust rules in light of the subsequent Spousal Impoverishment provisions added by the Medicare Catastrophic Coverage Act of 1988 (MCCA). This last of a three-part article on advanced Medicaid planning (see "Advanced Medicaid Planning: Spousal Impoverishment," July/August 1991, Vol. III, No. 1, and "Advanced Medicaid Planning II: Asset Transfers," October 1991, Vol. III, No. 3) will highlight only the primary planning concerns, since a growing body of literature is already devoted to the use of trusts in public benefits planning.

### Medicaid Qualifying Trusts

Congress's dislike of trusts, the flip side of its affection for home ownership, prompted it in 1986 to burden inter vivos trusts created by a prospective Medicaid applicant or his or her spouse with a special rule: Where a trustee has discretion to make payments of income or principal to the applicant, that income or principal is available for Medicaid purposes. 42 U.S.C.A. §1396a(k). Thus the first question to address in determining whether to recommend use of a trust to a client is whether that provision would apply to the proposed trust.

**State Rules.** The threshold question is whether the Medicaid Qualifying Trust (MQT) rules apply in your state to your trust. There are four ways the rules either would not apply or such application would not be significant.

1. *Inaction at state level.* The federal statute is written in mandatory language, but many states apparently have still not amended their state plans to reach discretionary inter vivos trusts. As with other discrepancies between the federal requirements and state plans (for example, transfers by community spouses of their own resources), whether state programs can apply the federal provision likely turns on

state administrative procedure law, although there are also federal due process considerations. See *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260 (1954).

2. *Gift and trust back.* In at least three states—Minnesota, Massachusetts, and Indiana—trusts established by an adult child for the benefit of a parent where there has been a substantial gift from parent to child have been used to avoid the MQT limitations. Such trusts are viewed as not created by the applicant or spouse and therefore are not subject to the limitations on the use of trustee discretion. In both cases, however, approval of the trust appears to have been at the local level. Often such trusts pass muster because intake workers look only at the face of the instrument, which shows that it was not created by the applicant or his or her spouse and thus is not on its face an MQT. The intake workers are not trained to look for step transactions.

3. *Court-created trusts.* A federal district court has held that trusts created by local probate courts under provisions drawn from the Uniform Probate Act are not created by the beneficiary, and thus are not subject to the MQT rules. *Miller v. Ibarra*, 746 F. Supp. 19 (D. Colo. 1990). While the HCFA regional office has disagreed, its explanation's premise was in error (referring to trusts "established by his legal guardian"). But see *Barham v. Rubin* on page 5 in this issue of *The ElderLaw Report*.

4. *Discretionary power only.* Where the MQT provisions do apply, they deem available only income and principal that are subject to trustee discretion. Payments actually made are, of course, available. The MQT provisions provide that if a trustee has discretion to make payments, then what the trustee could pay is available, even if not actually distributed. The obvious corollary is that principal that may not be paid out within the discretion of the trustee is not available by reason of this provision.

**Income under MCCA.** While the

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MQT rules preempt trustee discretion between the trust and its beneficiary, the MCCA spousal impoverishment provisions appear to permit the exercise of discretion among beneficiaries. Where a trust document fails to specify to which spouse income is to be paid, the statute provides that "if payment is made solely to . . . the community spouse, then income shall be considered available only [to] that spouse." This provides some room for protecting trust income through creative drafting.

**Principal.** A trust with trustee discretion to make distribution of principal for the benefit of a settlor or spouse, whether for support or otherwise, will fall within the MQT strictures when settlor or spouse seeks Medicaid benefits. Following are a few ways to grant the trustee some discretion without rendering all principal available.

1. *Distribution subject to third-party consent.* As reported in the September 1991 issue of *The ElderLaw Report*, Vol. III, No. 2, a recent Florida appeals decision holds that the requirement in a trust of an adverse remainderman's consent to distribution of principal renders that principal not available for Medicaid purposes. *Pollak v. Department of Health and Rehabilitative Services*, 579 So. 2d 786 (Fla. Dist. Ct. App. 1991). The trust fell within the definition of a Medicaid Qualifying Trust. While the trustee had discretion to distribute principal, the power was subject to the consent of the nontrustee daughters (or, if they were disqualified from acting by death, disability, or service as trustee, then by a majority of their competent adult children and the guardians of minor children). Without trustee discretion to make distribution, the court concluded, the principal was not available.

This decision highlights and approves a specific trust provision that will effectively shield an applicant's or spouse's trust from the consequences of being an MQT. But beyond that, it confirms what many attorneys have argued: that a provision making the power to distribute turn on something other than simple discretion would be effective for Medicaid planning.

2. *Special power to appoint.* A special power to appoint is the power under a trust to direct distribution of principal to a third party, not to the person with the power, nor to that person's estate or creditors. Typically a community spouse might establish a trust and retain a special power to appoint to his or her issue. Exercise of the power does not result in distributions to the settlor whose spouse seeks Medicaid, nor does the power reflect discretion of a trustee to make distributions to the spouse.

Such a power can be used for the welfare of a community spouse if, for example, the beneficiaries of the power are the children or grandchildren of the settlor and they use gifts made from the trust for the community spouse's benefit.

Use of special powers in Medicaid Qualifying Trusts has been written about widely (see "Using Reserved Special Powers of Appointment in Medicaid Planning," *The ElderLaw Report*, October 1990, Vol. II, No. 3), but there

are no known reports of decisions by Medicaid agencies or courts concerning whether such a power renders available the principal subject to it. As with distributions subject to a remainderman's consent, distribution under a special power of appointment is not the product of trustee discretion.

3. *Distribution subject to conditions.* A trust may provide for distributions of principal when certain conditions are met or situations arise. A "five and five" power (permitting distributions to a spouse or child of the greater of 5 percent of the principal or \$5,000, once a year) allows limited distributions when a condition — the passage of a year's time — has been met. A trust might provide alternatively that the trustee is to distribute all or a certain amount of the principal to the community spouse on his or her spouse's death. Both conditions are certain to occur (although whether the community spouse will have survived or be in a nursing home at that time is uncertain). A contingent condition might provide for distribution if the spouse changes residences or incurs debt of a certain amount. Or, like some of the solutions to the rule against perpetuities ("upon the death of the last survivor of all of those individuals named in the Manhattan telephone directory at the time of my death"), the condition might have nothing to do with the settlor, for example, on the election of a Republican as president (just to be on the safe side).

Such powers provide for distributions at some time in the future. Because the deeming of spousal resources is limited to the initial eligibility determination, and the community spouse's resources are not taken into account after the first month of eligibility (42 U.S.C.A. §1396r-5(c)(4)), the actual distribution after eligibility will not affect future eligibility.

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### Waxman Opposes Provider Tax Restrictions

The Bush Administration has issued new regulations forbidding the state practice of using provider taxes and contributions to pay part of the state's share of Medicaid costs. (See "The Other Foot Drops: United States Limits State Medicaid Funding Mechanism," Vol. III, No. 3, October 1991.) Representative Henry A. Waxman, Chair of the Energy and Commerce Subcommittee on Health and the Environment, called hearings on the Administration initiative.

"The states clearly have the authority to use provider tax revenues to pay for the costs of their Medicaid programs," Representative Waxman said in his opening statement. "However, rather than doing it the old-fashioned way, coming back to Congress and asking for an amendment, the Administration has decided to simply legislate by regulation." Representative Waxman characterized the new restrictions as "illegal, ill-advised, and ill-timed."

The question is what, if any, value a Medicaid agency will assign to such a future distribution.

4. *Third-party distributions.* Another solution is to give the trustee the power to distribute principal to the issue of the grantor. If the trustee is not the grantor or his or her spouse, this should not cause the principal to be deemed available. To make this more certain, the trust can give this power to an independent trustee not subject to control by the grantor or his or her spouse.

5. *Loans.* Loans at reasonable interest rates are not payments or distributions. If the trust is a grantor trust, the interest payments would not be reported as income to the trust because they are paid, for tax purposes, to the grantor.

### Third-Party Trusts

Trusts created by one person for the benefit of another (not a spouse) — typically children or other relatives, perhaps an ex-spouse as part of a divorce settlement — can be used to assist the beneficiary without thwarting his or her eligibility for SSI, Medicaid, or other public benefits. Where the settlor has no duty to support another person, such as a parent, adult child, former spouse, or other relative, a properly drafted trust can provide income and principal to supplement public benefits without adversely affecting eligibility.

To be effective, the settlor's intent to supplement rather than supplant public benefits should be clear from the trust document. Although not recommended as a matter of planning even where the term "support" occurs, the intent to limit the trust to "luxuries" or other needs can be inferred from broad trustee discretion, directions to the trustee to take other resources and benefits into account in making distributions, modest principal (so that it could not in fact provide support for any time period), multiple beneficiaries, and such other factors that would support a reasonable inference about settlor's intent.

A number of state statutes attempt to preclude use of trust provisions designed to insulate income or principal from availability for public benefits purposes. In some cases, the more clear the intent, the less likely the provisions are to be effective. But how such statutes apply in a specific case is often problematic. A New Jersey statute, for example, provides that a trust provision that "reduces . . . payment for . . . services to an individual because of that individual's eligibility for . . . Medicaid benefits shall be null and void." N.J.S.A. §30:4D-6f. While this might reach a provision that restricts trustee discretion in the event of eligibility, it is not entirely clear that it would reach a trust drafted affirmatively to permit distributions for specific purposes, such as providing clothes, personal effects, travel and entertainment, and equipment.

This and other statutes in New York and California, and state court decisions in Pennsylvania, New York, Minnesota, and Ohio, counsel great prudence when planning to use a trust to wrap around public benefits.

### Court-Created Trusts

Court-created trusts for the benefit of a ward are useful in two situations. First, they keep income away from wards in states without medically needy programs; such trusts enable the beneficiaries to qualify for benefits that otherwise would be denied because their income is above the eligibility limit but insufficient to pay for nursing home care at private-pay rates. Second, they can accept personal injury settlement payments or inheritances that otherwise would disqualify the ward for public benefits.

**Income cap states.** States that limit eligibility based on income (at 300 percent of the SSI level, now \$407 per month, or \$1,221), regardless of medical expenses, can deny Medicaid nursing home benefits to over-income individuals, leaving them with no way to pay for necessary nursing home care. Attorneys in Colorado came up with a creative, and successful, solution: They obtained authority under the state's version of the Uniform Probate Act for the creation by the probate court, in a guardianship proceeding, of an "income" trust. The trustees were authorized to receive all their wards' income but were restricted from distributing to or for the benefit of the wards an amount that would disqualify them for Medicaid benefits for institutionalized persons. Trustees in four similar cases then sought declaratory relief in federal court to establish that their wards could not be denied Medicaid benefits by reason of their income. The trustees prevailed. *Miller v. Ibarra*, 746 F. Supp. 19 (D. Colo. 1990). Moreover, the Denver regional office of HCFA has since indicated its acquiescence in some, but not all, of the key elements in the decision. See "Medicaid Affirms *Miller* Decision; Questions Proposed Colorado Legislation," *The ElderLaw Report*, July/August 1991, Vol. III, No. 1.

The key holdings, and HCFA's response, were as follows:

1. The beneficiaries' present interest in the trusts did not rise to a level that would make either the principal or undistributed income available to them for Medicaid purposes.

2. The creation of the trust, and the transfer of interests to it, were not the voluntary acts of the wards, and in light of the federal policy behind the restrictions on transfers, were not to be imputed to the wards. HCFA appeared to go beyond this and conclude that even a voluntarily created income trust would be permitted. Of course, this may be of little significance where income is not assignable, as with Social Security and civil service pensions (without the consent of the Office of Personnel Management), or where it is difficult to arrange, as with most private pension payors.

3. The transfer rules apply to resources, not income. HCFA agreed with this, but its reasoning was less than clear, as it also emphasized that the income in these cases was routed around the Medicaid applicant.

4. The trusts were not Medicaid Qualifying Trusts because they were not created by the Medicaid applicants. The HCFA regional office disagreed with this conclusion but

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properly noted that the remaining question concerned only the scope of trustee's discretion, which was severely limited in this case.

The court emphasized that these trusts were meant for the limited purpose of qualifying individuals with low (but not low enough) income for benefits, that many of the federal and state proscriptions regarding transfers and discretionary trusts were directed at the wealthy, not people such as those represented in *Miller*, and that the trusts provided that any funds remaining on the death of the ward would go to the state.

**Court-created supplemental needs trusts.** Courts have also been called to endorse the creation of — or themselves to create — supplemental needs trusts to protect two other classes of people who need the coordination of public and private benefits. In both groups the ward is incapacitated, by age or some kind of mental incapacity or both, and has become entitled to a substantial amount of money. One group comprises those, often children, who are successful plaintiffs in personal injury litigation where the injury leaves them unable to be independent and self-supporting when they reach adulthood. The other class is composed of heirs, sometimes older or elderly, who were cared for by the deceased parent but who did not receive proper estate planning.

The threshold problem is persuading a court to approve such a trust. The likelihood of prevailing is greater to the extent the beneficiary has needs that will not be met by public assistance or other insurance and where the benefits pass to the individual and not to his or her heirs.

As in *Miller v. Ibarra*, certain issues need to be resolved, including whether the trust is deemed created by the beneficiary, thus triggering MQT restrictions, whether funding the trust is a transfer by the beneficiary, and whether income or principal of the trust is considered available.

In *In re Gordon*, D.C. Superior Court, Inter. No. 198-90, a mildly retarded 60-year-old woman stood to inherit half of her father's \$200,000 estate. This would disqualify her for both Medicaid and SSI benefits, and while she had Medicare disability benefits, her income would still be inadequate to meet her housing and health care needs. The court was asked to authorize her conservator to disclaim her share on the condition that the other heir would fund a trust for her benefit. As such a trust could not be crafted in the few days remaining before the deadline for disclaiming, the court exercised authority, identical to that in *Ibarra*, to create the trust itself. *Order for Trust*, June 3, 1991. But see *Barham v. Rubin* on page 5.

### **Trustee Discretion**

A further question arises over the scope of the trustee's authority. The beginning point must be an analysis of the ward's needs. While neither support nor broad medical needs coverage should be authorized, the focus should be on needs for special housing and support services, as well as goods or equipment, not available from a benefits program, that could help the ward. Moreover, even without the MQT

problem, distributions actually made by the trustee become available as either income or principal of the beneficiary, and even third-party payments may be considered income if for food, clothing or shelter under the SSI regulations.

### **When Does the Transfer to a Trust Occur?**

1. *On funding the trust.* The beginning and end of any period of ineligibility depends on the date it occurs. In most cases, the transfer occurs when title to an asset is changed from the individual to the trustee. Whether that would be the case with a grantor trust of which the settlor (applicant) is sole trustee is somewhat uncertain. A transfer might occur when the settlor resigns as trustee, but it is unclear whether there would be a transfer when the settlor's powers as trustee were terminated because of his or her incompetence.

2. *Exception for "sole benefit" trust.* In contrast, transfer of assets to another for the "sole benefit" of a community spouse is exempt. 42 U.S.C.A. §1396p(c)(2)(B). The question is, what constitutes "sole benefit"? Looking to federal income and estate tax law as a guide, tax rules for the determination of the ownership of a trust may approximate the notion of sole benefit. Thus the community spouse would be the owner of all assets of an irrevocable trust over which he or she enjoyed a general testamentary power of appointment and a special inter vivos power to appoint income or principal among his or her issue, yet had no right to distribution of principal to himself or herself during his or her life. This analogy may not answer the question whether transfer to such a trust would be exempt from the MQT transfer penalties by reason of the spousal impoverishment provisions of MCCA.

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## **The ElderLaw Report Subscriber Medicaid State Law Survey**

With the passage of the Medicare Catastrophic Coverage Act of 1988 (MCCA), Medicaid rules in different states became more uniform. But as interpretations of the MCCA transfer and spousal impoverishment provisions have developed, the rules and practices gradually have become *less* uniform. Since the MCCA rule is still in many ways untested, it is useful to find out what is happening in other states.

Toward that end, the following insert contains a subscriber survey on state Medicaid law. Please fill it out and return it in the enclosed envelope. We will compile the results and publish them for your use. The more complete your response, the more information we can supply the newsletter readership. So please take the time to complete the survey. Thank you for your contribution.