Grandfathering, my Subaru, and Special Needs Trusts

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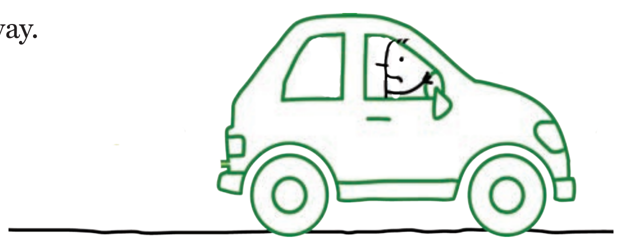
At age 28, I was carded while buying a bottle of wine. I had brown hair and I was questioned whether I was over age 18. Like my father, my hair started turning white very quickly. At age 32, I looked 42. In four years I had aged 24 years. When I was 35, I was interviewed in the process of renting a one-week vacation home and was asked, "Are you retired?" I was with my young family and suddenly I had become the "grandfather". My wife has always looked younger than her age and on more than one occasion she was asked, "Why did you marry a much older man?" Her response: "He is only 3 years older".

I am sensitive to this issue. Fortunately, the only time that I feel like a grandfather is when I back out of my driveway.



My Subaru

My motive in buying a Subaru, at first glance, looked like my efforts to drive safely in Vermont winters. It wasn't. I simply fell in love with the new gadgets. It was a happenstance visit to a local dealership and I fell in love with the back-up camera and the apps that appeared on what looked like an iPad on the dashboard. Now I could address the problem of backing out of the driveway. Often I would say, I am 90 years old when I back up, but when I drive forward I am still 18. Then I discovered so many other safety features to justify the purchase....that is until I discovered that the enhanced features may have even created greater risks. I found five manuals with over 1000 pages in the glove compartment to help me understand the car I had just bought. I am simply not able to understand most of the features, but I try, unfortunately while driving and looking at the screen to my right on my dashboard.

My Subaru has some nice safety features. If I start to stray out of my lane, a buzzer will sound, hopefully in time. But am I safer now then when I owned an old Dodge Dart when I was 28? Probably not. In those days I simply turned on the radio and my right hand scrolled through stations until I heard the station I wanted. My eyes rarely strayed from looking over the steering wheel. If I were an advisor to the auto industry, I would simply suggest strapping an iPad over the steering wheel, rather than looking at a screen to my right, for a better field of vision.[1]

Grandfathering

In the world of estate planning, we often make decisions based on the concept of grandfathering. The term "grandfathering" is used to describe a statutory or contractual willingness to allow some activities or former rights to continue, even though not technically allowed under current law. In the tax world it dominates. For example, we encourage clients to use their assets to make gifts to save taxes, and, if the tax law changes, the gifts ordinarily would escape taxes in spite of the change in the tax law.

Why the name "grandfathering"? I don't know, except perhaps to evoke an image of being kind to our grandfathers who

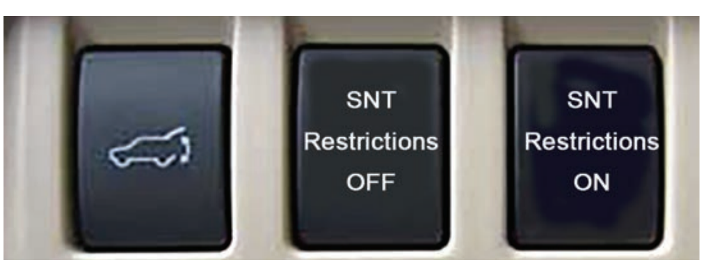
made decisions and we, the grandchildren, do not want to overrule them. In the world of Special Needs Trusts, more often than not, grandfathering does not apply. Why? Perhaps because it is the government's money, not the grandfather's assets, that will have an impact on the special needs of the beneficiary of the trust.

Special Needs Trusts

If you go to a lawyer and you are considering a trust for a person who has, or may have, special needs, they may recommend a restriction that would not allow the trustee to make distributions for food, clothing, shelter or health care that could be provided by government benefits or assistance. Well, the definition of government benefits or assistance is daunting, both federal and state: SSI, SSDI, Medicaid and state benefits. Sort of reminds me of my Subaru. These are benefits designed to reduce financial risks but they might actually create unanticipated risks. The complexities of a 1,000 page manual may have us drive in the wrong direction.

Let's say the person with special needs receives SSI, which currently is limited to $735 per month.[2] As trustee, I may be barred from paying the rent, directly or indirectly, for the benefit of the beneficiary. Even in Vermont, housing at this price may be very unattractive.

These are very complex rules in an environment that does not grandfather the rules. The SNT trust as designed today may be effective today, but not tomorrow. Trying to understand my Subaru manuals, which don't change, and SNT manuals that do, may have one thing in common: focus on key safety buttons.



The first button is to turn off the SNT restrictions. Here is an example of safety button one:

"Notwithstanding the provision barring distributions that would diminish government support, the trustee may make distributions to meet the beneficiary's need for food, clothing, shelter or health care, even if such distributions may result in an impairment or diminution of the beneficiary's receipt or eligibility for government benefits or assistance."

This is the type of clause we should discuss with our attorneys. In response, the attorney may suggest a second button that will turn on the safety button if necessary. Here is an example of safety button 2:

"If the mere existence of the trustee's authority to make distributions pursuant to this paragraph shall result in the beneficiary's loss of government benefits or assistance, regardless of whether such authority is actually exercised, this paragraph shall be null and void and the trustee's authority to make such distributions shall cease."

The next question is: do you want the second button? The impact of saving dollars may have unanticipated consequences. My example above did not mention the risk of Medicaid benefits that might be vulnerable as well.

Estate Planning & Special Needs Trusts is still in its infancy. When I review Special Needs Trusts I see a field of expertise that is still in its adolescence. To all lawyers and their clients who use Special Needs

Trusts (or its sibling, a Qualified Disability Trust) as my grandfather might say, the legislators may pull the rug out from under you.

I like my Subaru. It is a safe car if I don't look at the dashboard screen too often. It is a solid car and would make a great bumper car. In the world of Special Needs Trusts, we have several bumper cars: those that administer the government programs, the IRS, and lawyers and accountants that do not prepare tax returns for trusts (a fiduciary tax return).

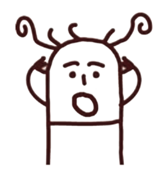
In the tax world, there are two types of Special Needs Trusts: The First Party Special Needs Trusts and the Third Party Special Needs Trust.

All income of a First Party Special Needs Trust will be reported to the IRS as if it had been paid to the person, even if the trustee made no distributions to the person with special needs.

The trustee of Third Party Special Needs Trust may or may not send a tax letter to the person with special needs, depending on whether distributions were made to or for the benefit of the person with special needs. The tax rules are different then the rules used by those who administer government programs, such as the Centers for Medicare & Medicaid Services (CMS). If the trust buys an iPad for the special needs person that costs $800 and the trust earns $800, then the special needs person will receive a tax letter saying he or she needs to report $800, assuming no other income or disbursements for the year. CMS will probably take the position that this is not income that will reduce the disability benefits. Fortunately, the two organizations talk to each other. But what about accountants and lawyers who do not do fiduciary tax returns? They might be inclined to suggest no disbursements for expenditures that would disqualify the person with special needs. That said, the income in the trust may be subject to a much higher tax rate in the trust. Often it is not as simple as it looks.

I drove my Subaru to an intersection having inadvertently set one of the safety buttons, and my car would not let me go right on a red light when the only traffic was on the left lane. I worried about the car behind me. Who was in the car? A lawyer? An IRS agent? Someone who works for CMS? Or those just prone to road rage?

I still love my back-up camera. But then again unanticipated consequences: a middle-aged man drove into our company parking lot with a car with the same back-up camera. My greeting started with how much I love the back-up camera and, "I am 90 years old when I back up" but I paused for just a second to finish with "but when I drive forward I am still 18". During the pause he said, "So you are 90?"



Endnotes

1 To those who were not raised in my household, this is a joke.

2 Notes to attorneys: the objective of the newsletter is to create a discussion. My example did not focus on the risk of Medicaid benefits. Payments on behalf of beneficiaries, rather than direct payments, may reduce but not eliminate benefits so the trustee can contribute enough to provide adequate housing. Button 1 does allow this. If you feel a need for button 2, you might be able to modify button 1 to allow for modest diminutions, but not impairment, and avoid button 2.