Using A Sole Benefit Trust for Medicaid Spend Down

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July 2022 - Vol. 16, Issue 5

An often-overlooked tool for long-term Medicaid planning purposes is the sole benefit trust (SBT). How powerful the SBT can be depends on whether the person with a disability is receiving Supplemental Security Income (SSI) or Social Security Disability Insurance (SSDI) benefits. While SSI has income and resource limitations on funds received from an SBT, SSDI has no such income or resource limitations.

How do Sole Benefit Trusts work?

Sole benefit trusts are a type of special needs trust (SNT). "A transfer is considered to be for the sole benefit…if the transfer is arranged in such a way that no individual or entity except the spouse, blind or disabled child, *or disabled individual* can benefit from the assets transferred in any way, whether at the time of the transfer or at any time in the future."

Any individual under age 65 who has a disability determination qualifies to be named as a beneficiary of an SBT. That individual need not be related to the person creating or funding the SBT. The distributions to the beneficiary must be made on an actuarially sound basis. If, for example, a beneficiary's life expectancy, determined by Social Security, is 20 years, and the SBT is funded with $100,000, then distributions to the beneficiary *cannot be less* than $5,000 a year. The required distribution is recalculated annually based on the total amount in the SBT and the beneficiary's life expectancy. The key is that the distribution to the beneficiary cannot be *less* than the actuarial amount, but the trust can give the trustee of the SBT discretion to make larger distributions to the beneficiary if the trustee decides it is in the beneficiary's best interest to do so.

Who Would be a Good Candidate?

If an unmarried individual seeks to qualify for Medicaid to pay for long term care costs in a nursing facility, he is generally not permitted to have more than $2,000 in countable assets. If those excess resources are transferred to someone within five years of filing the Medicaid application, a transfer penalty will be assessed, except under limited circumstances. One such circumstance is a transfer to an SBT, which is an exception to the “transfer for less than fair market value” rule.

A good candidate to take advantage of an SBT is a Medicaid applicant who does not have a spouse or a child with a disability to whom a transfer can be made directly without incurring a penalty. If the applicant knows a disabled individual under age 65 then all of the applicant’s countable resources above $2,000 can be transferred to an SBT for the benefit of that individual, allowing for the applicant to qualify for long-term Medicaid benefits as of 12:01 AM on the 1st day of the month following the date of the transfer. Because there are no income and resource limitations on an SBT beneficiary who is receiving SSDI, an SBT is a more powerful tool when used for the benefit of the SSDI recipient. An applicant can also spend down by establishing an SBT for an individual who receives SSI benefits, albeit with fewer options.

Let’s look at a couple of examples:

Example 1: Steve/SSDI

Steve’s daughter Lisa is not disabled, but Lisa’s husband, Gerald, is currently receiving SSDI and Medicare. Steve is about to go into a nursing home and currently has $250,000 in CDs. Steve must either pay the nursing home $8,000 a month or find a way to qualify for Medicaid. With CDs valued at $250,000 Steve has $248,000 in countable assets.

One option for Steve is to establish an SBT for the benefit of his son-in-law, Gerald. Steve will establish the SBT with $248,000, and Lisa, Steve’s daughter, will serve as Gerald’s trustee. Steve would qualify for Medicaid, and then Lisa would make monthly distributions from the SBT directly to Gerald as there are no resource or income limitations on his SSDI benefits. Once Gerald receives the distribution there is also no limitation on how he can spend the money. He could even use the money to purchase items for Steve as long as what he purchases is not considered a countable resource. Additionally, Steve has the right to name remainder beneficiaries in the trust document in the event Gerald should die. Steve would likely name Lisa and his lineal descendants. (Check your state regulations regarding possible gift or inheritance tax consequences.)

Example 2: James/SSI

James is about to go into a nursing home. He does not have a spouse and does not have any children who are blind or disabled. He does have a daughter Cindy, who is married to Timmy, who is receiving SSI. Timmy is not as concerned with the loss of his $800 in income from SSI as he is with losing his Medicaid and the $10,000 a month in medical bills that it pays for him. Timmy is 56 years old. His life expectancy is 25 years. James wants to protect a $500,000 home and $100,000 in a brokerage account for Cindy. James also wants to qualify for Medicaid to pay for his long-term care.

James can establish an SBT for Timmy funding it with the home and $100,000 cash, with Cindy as trustee. Cindy must initially distribute $24,000 a year to Timmy. (Note: Some states to not allow a home to be transferred to an SBT.)

Timmy does not own a home so the first year Cindy transfers ownership of the home to Timmy. This satisfies the first-year requirement of the SBT making distributions that are actuarially sound to Timmy. The following year there is only $100,000 in the SBT, and Timmy is now 57. To be actuarially sound Cindy must now distribute $4,166.67 to Timmy ($100,000/24 year life expectancy). This distribution can be spread out over 12 months at $347.22 per month ($4,166.67/12=$347.22). Timmy receives $800 a month in SSI. As long as he receives $1 a month in SSI, he keeps his Medicaid. Using this strategy Timmy's SSI would be reduced by the amount he receives from the SBT, but he would be able to keep his Medicaid. The trust's distributions would offset the loss in SSI and James would be eligible for Medicaid for long-term care. James would likely want to name Cindy and his lineal descendants as the remainder beneficiaries. (Check your state regulations regarding possible gift or inheritance tax as well as your state's specific rules regarding Medicaid and SSI eligibility.)
