



What is a special needs trust anyway?

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There’s a short answer and a much longer answer to this question.

The short and simple answer is that the words “special needs trust” describe a trust whose mere existence won’t cause the trust beneficiary to lose means-tested government benefits. That is, it won’t count as a “resource” when qualifying for the type of government benefits that are restricted to people with “resources” below a certain level—such as SSI and some kinds of Medicaid. Also, the income that the trust earns and retains won’t count as the person’s income. (The trustee may still mess up the person’s benefits by making inappropriate distributions, but that’s another article.) The beneficiary will keep government benefits and still get benefit from the trust.

As usual, when it comes to laws and regulations, things are never that simple. Romeo asked “What’s in a name? A rose by any other name would smell as sweet!” We wish government bureaucrats understood this about trusts, but often they don’t. There is more than one kind of “special needs trust,” those funded by a “third party” (in other words, someone who isn’t the beneficiary), and those funded by a “first party” (in other words, the beneficiary). You won’t find a dictionary definition for either. It’s important to understand the different kinds of special needs trusts and refer to trusts with caution.

Before I get to the longer answer, let me tell a short story. I represented a man with a psychiatric disability. His mother died, and her will left him her house in trust. The will said that the trust was for his special needs only and even said that if he lost his benefits because of the trust, the house should go to charity. He told Social Security he had a “special needs trust,” gave them a copy of the will—and promptly lost his benefits. Of course, this was all a terrible mistake and after a couple of years and a hearing with a judge (and paying a lawyer), he got his benefits back. But if only he had described the trust some other way! When the folks at Social Security heard him say “special needs trust,” they

thought he meant a “first party” trust (which it wasn’t) and decided the trust in his mother’s will didn’t qualify. The wrong words lost him benefits for two years.

So here is the longer answer, which explains how the use of the term “special needs trust” evolved from a term used for “third-party” trusts to one more often used to describe “first-party” trusts, but which is often used by lawyers and family members to describe both.

Once upon a time, the term “special needs trust” meant that a family member (never the beneficiary) would create a trust to pay for only the “special needs” or extras of the beneficiary, on the assumption that the beneficiary’s government benefits should be providing for the basic needs. The trust might be titled “the John Doe or Suzy Q Special Needs Trust.” Even if the trust’s terms *allowed* the trustee to pay for basic needs such as housing or medical care, the trust document would also allow the trustee to *refuse* to pay for these things, usually by giving the trustee “absolute” or “unreviewable” discretion. Most documents would also include the clear statement that the trust was intended not to affect government benefits, to prevent a court from deciding that the trustee had an implied duty to pay for the person’s basic needs even if the trust document didn’t say that. It was the trustee’s legal right and power to refuse payment for the beneficiary’s basic needs that prevented the government from treating the trust as the beneficiary’s resource and allowed the beneficiary to keep means-tested government benefits.

These trusts still work! Family members still create them and the law hasn’t changed—if the trustee can refuse to pay for basic needs, if the beneficiary has no legal right or power to make the trustee pay for basic needs, the trust is not a resource and government benefits should not be affected. These days, however, the safest thing to do is to call it a “third party” supplemental needs trust when talking with government officials and not to use the term special needs trust. Even though a lawyer who does “special needs” law or drafts “special needs trusts” may create this trust, and even if it’s not *wrong* to use the words “special needs trust,” it’s still not a good idea to use those words when dealing with government agencies.

What happened? When did the generic term “special needs trust” start having a special meaning for government agencies?

In 1990, some disabled people won a lawsuit in a case called *Zebley*. Unfortunately, when they won, they lost their Medicaid and were no better off than before the lawsuit. This was because at that time, a person couldn’t set up a trust with the person’s own money—under most state’s laws, doing so would always cause the loss of benefits. (“The person’s own money” includes money left directly to the person, such as a will naming the person directly as a beneficiary, proceeds of a lawsuit that the beneficiary won, or assets that

belonged to the person prior to applying for benefits, such as savings the person had before an injury.)

When the plaintiffs in the *Zebley* case lost their benefits, there was outrage. Congress changed the federal law to say that a person could put assets in a trust that was set up for the person's own benefit and still qualify for Medicaid, so long as the trust met certain requirements—most importantly, so long as the trust paid back Medicaid when the person died. This change created section (d)(4)(A) of Section 1396p of title 42 of the U.S. Code, part of the Social Security Act. You can google 42 U.S.C. 1396p(d)(4)(A) if you want to see it—scroll way down until you get to “(d).” This is why some people still refer to this new type of trust as a “d4A trust.” (Footnote: Congress only made this exception for SSI and Medicaid. States may have their own benefits with different rules and there are even other programs, such as Section 8, that will treat trusts differently.)

This law doesn't say anything about “special needs”! The words aren't even there. But since the “d4A trust” doesn't affect Medicaid or SSI benefits, and the other type of trust set up by family members (the third party trust) also doesn't affect benefits, somehow the new d4A trust got tagged in the court cases and agency rules as a “special needs trust.”

To be perfectly clear — *when used as a technical term by government officials or courts, “special needs trust” usually refers only to this “d4A” trust and not the other kind.* And to qualify as a “d4A” trust, the trust must meet certain requirements, including that (1) the assets were transferred to the trust when the beneficiary was disabled and under sixty-five, and (2) the trust document has a clause saying that when the beneficiary dies, any Medicaid benefits that the beneficiary received when alive must be repaid to the states that provided these benefits—known as the “payback” clause. In addition, these trusts originally could only be set up or signed by a parent, grandparent, guardian or conservator of the beneficiary, or a court, but since December 13, 2016 can also be signed by the beneficiary as the trust's creator (usually referred to as the “settlor” or “grantor”).

The problem is, if you call a third party supplemental needs trust a “special needs trust,” and it doesn't have a payback clause, the Medicaid agency or Social Security will say that it doesn't meet the “special needs trust” requirements and therefore will count it as a resource and the beneficiary may lose benefits or at a minimum there may be problems. That's what happened to my client. This will be a mistake; no payback clause is required unless the trust assets belonged to the beneficiary in the first place (or, in some states, also if a “third party” is about to apply for Medicaid—as if the person first gave money to the beneficiary who then set up the “first party” trust.) A better name for this type of trust in most cases might be a “first party” special needs trust, because it was and is the only kind of trust that can be created with the owner-beneficiary's assets and yet not be counted as

the beneficiary's resource. Or a "payback" trust — that's what bureaucrats really care about. Social Security used to call these "Medicaid exemption" trusts.

Unfortunately, over time, the term "special needs trust" has become associated with those first-party trusts that must have a payback clause. Even though the third party trust document may say that it is set up for the beneficiary's "special needs" and even though the first party d4a payback trust doesn't even have to mention special needs in order to qualify, the bureaucrats will probably look for that pesky payback clause any time you say "special needs trust." So, when dealing with legal matters or a government bureaucracy, it is best that the words "special needs trust" be used *only* for the first party, d4A, payback trust.

What's in a name? Sometimes, everything.

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