

The Third-Party Pooled Trust: an alternative planning tool to help avoid the biggest mistakes in special needs planning

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Individuals seek professional guidance to protect their assets, children, spouse, partner or other family members after they are gone. If their loved one is an individual with disabilities who depends on means-tested public benefits to meet his or her basic needs, it is essential to choose experienced counsel to help protect his or her present and future eligibility. Individuals who do not hire counsel, whether from a lack of sophistication or resources, may resort to disinheriting their child with disabilities and leave a disproportionate share to a sibling who, it is hoped, will “do the right thing.” While this is the least expensive approach, it provides no protection for their special needs child, and as such, it is the number one planning mistake many families make. The designated sibling may use the funds for themselves, especially if they encounter personal financial difficulties. The assets may become part of marital estate in the event of divorce, disability or death, and they are vulnerable to the creditors and claimants of the designated sibling.

In order to protect vulnerable family members, counsel will properly suggest a custom drafted third-party special needs trust as part of a complete estate plan. Most third party trusts are created either by execution of a custom drafted document, or

through use of a third party joinder agreement with a pooled trust.¹ Even though other family members, especially those without children of their own, may wish to make a bequest to a family member with special needs, parents fail to inform them of the existence of the third party trust. As a practice point, counsel should inform the client how to instruct others to make current or future gifts to the trust and the tax consequences of doing so.

However, not all families are of sufficient means to warrant a complex estate plan. They may have difficulty paying legal fees for the creation of this type of estate plan, or it may be too complex for them to manage. They may never fully fund the trust, or review the plan again. All of these factors contribute to the reluctance to create a comprehensive estate plan for themselves or periodically revise their existing plan. Counsel may consider the use of pooled trusts to assist families in exploring options which are cost effective and help meet the particular needs of their family member with disabilities.

A pooled trust, as defined by 42 USC §1396(p)(d)(4)(C)², is created and administered by a non-profit entity to manage and protect the assets of individuals

¹ Social security defines a third party trust as “a trust established by someone other than the beneficiary as grantor.” POMS SI 01120.200(B)(17). A grantor is further defined as the party who provides the res of the trust. POMS SI 01120.200(B)(2). To qualify as a valid third party special needs trust the beneficiary must have no ability to revoke the trust or direct distributions in any way (42 USC §1382b(3)(3)(A), 20 CFR §416.1201(A)(1); POMS SI 01120.200(d)(2)).

² A pooled trust is defined in 42 U.S.C. §1396p(d)(4)(C), which states: “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 funds, the trust pools these accounts. (iii) Accounts in the trust are established solely for the benefit of individuals who are disabled

with disabilities who are dependent upon governmental benefits to meet their basic needs, such as shelter, medical care, food, and income. An individual with excess assets, his or her parent, grandparent, guardian or court actions on his behalf, can place his or her excess funds into the trust and thus maintain their eligibility for governmental benefits.³ In order to become a member of any pooled trust, the beneficiary, or other recognized authority as listed above, must execute a Joinder Agreement which dictates the terms under which the beneficiary will become a member of the pooled trust. While maintaining separate accounts for each individual member, assets are pooled together to maximize the return on investments, to spread the cost of administration and management among the members, and to reduce those costs through economies of scale.

Pooled trust administrators apply these same principles to the administration of third party funds for individuals with disabilities. Pooled trusts are as varied in culture, fee schedule, asset management, and administrative style as other corporations, and there are many choices in pooled trusts, ranging in scope from local to national organizations.

(as defined in section 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."

³ Parents with eligibility issues can also transfer assets to their child with special needs without penalty pursuant to 42 U.S.C. §1396p(c)(2)(B)(iii), and the funds must be placed in a self-settled trust, which mandates either a payback to the State or retention of the remaining assets.

When reviewing the pooled trusts available in your state, counsel should consider several factors: (a) the reputation of the non-profit and trust within the locality of the client being served, (b) the cost of membership such as initial set up fees, perpetual and extraordinary fees (which varies greatly), (c) the longevity of the pooled trust, (d) reputation and experience of the counsel and administrators, (e) the ease and method of requesting distributions, (f) the performance of the investments and oversight of same, (g) availability of advocacy on behalf of the beneficiary, and (h) the retention policy of the trustee. Choice of pooled trusts, in many cases, depends on the recommendation of counsel creating the estate plan. Counsel should not make recommendations based on costs alone, but all of the listed factors, including compatibility of the emotional needs of the client with the trustee.

Many pooled trusts have developed third party joinder agreements to allow parents or other family members to make current or future gifts to their loved one with disabilities. The method for determining the residual beneficiaries and the terms by which they receive funds vary greatly among pooled trusts. Typically, there is very little drafting required by counsel when using a third party joinder agreement, as the agreement itself is created and implemented by the non-profit trustee. The trustee may have a standard joinder agreement which contains provisions that are filled out by family or their counsel as to the disposition of any remaining assets.

Other pooled trusts may implement a joinder agreement which references an addendum to the joinder agreement outlining the grantor's wishes. As with other

third party special needs trusts, there is no payback required to any governmental entity. However, counsel should thoroughly investigate the non-profit trustee's policy regarding the fees associated with disbursement of the residual funds to the designated beneficiaries, and whether the trust retains a percentage or charges a flat fee for wrapping up the affairs of the trust.

Each family is unique in dynamic and presentment of issues. Use of the pooled trust joinder agreement provides flexibility when the parent is not sure whether governmental benefits will be necessary. Given the uncertainty as to their child's potential for achievement and self-supporting independence, counsel can incorporate language which will allow the trustee of the parent's trust agreement to convert the trust to a special needs trust.⁴ Counsel should attach an executed joinder agreement to the Grantor's revocable trust agreement. The grantor, or other family members, provides enough initial funding to qualify the trust as a seed trust, typically a nominal amount. In a more simple estate plan where a simple last will and testament are most appropriate, counsel can also reference the pooled trust as beneficiary on behalf of the heir or devisee with disabilities, and attach an executed joinder agreement. This

⁴Sample trigger provision provided by Susan Tomita: "It is the intention of the Grantors, should the Trustee determine that it is in the best interest of a beneficiary to qualify for needs based public benefits, that the Trustee have the discretion to amend the trust (or a trust share) to allow such qualification. Consequently, the Trustee shall have the power, if the Trustee deems it to be in a beneficiary's best interest, to transfer the assets of the trust (or of any trust share) to a special needs trust or to convert the trust (or any trust share) into a special needs trust for the benefit of the beneficiary of the trust (or any trust share) that will allow such beneficiary to qualify for Supplemental Security Income, Medicaid, or other governmental assistance."

method allows the will to serve as a conduit for funding the special needs trust for the individual with special needs, thus creating a simple, cost effective estate plan that adequately protects the child with disabilities.

Using a pooled trust for third party funds may also offer a unique opportunity for the grantor and beneficiary to experience the pooled trust administration during the lifetime of the grantor. The parent, prospective caregivers, and beneficiary can form a relationship with the pooled trust administrators before the parents are gone. By forming a bond and creating an additional support for the beneficiary during the life of his or her parent, there is less stress after the parent(s) are deceased, and any issues with administration can be worked out ahead of time. It is also an opportunity for any nominated successor advocate to ease into their role by working with the beneficiary and the trustee.

Third party pooled trusts also help to eliminate choice of trustee issues as family members cannot serve as trustee. Rather, pooled trusts must be administered by the non-profits that created the fund, and typically do so with the assistance of counsel. Choosing the wrong trustee is another common mistake parents make when completing their estate plan. Parents naturally place administrative responsibilities for their own fiduciary needs on their adult children, who are typically the natural choice for trustee of the third party special needs trust. However, administration of these trusts is not like wrapping up the affairs of their deceased parent's trust, which at some point will terminate. A special needs trust is particularly complex in that the

trustee must provide management of the funds, be aware of changing public benefits policies, have a working knowledge of community and governmental resources, anticipate the impact of distributions on benefit eligibility, community, state and federal benefit programs, address tax issues, and be able to advocate for the beneficiary should benefits be eliminated. The siblings may or may not be familiar or comfortable with the role of advocate for their sibling with special needs. They or their spouse may become resentful of the time and attention required. The use of a pooled trust and its professional administrators and their counsel helps eliminate these issues, and possibly others as well. When the sibling is thrust into the role of trustee for life and has full discretion over the use of funds, it can place unnecessary stress and friction on that relationship. There is also a natural conflict of interest if the sibling is the remainder beneficiary and the trustee. Every dollar spent on their siblings needs is one dollar less that they will eventually receive. In addition, many pooled trusts provide the type of professional administration that would otherwise be unavailable for the size of assets under management.

Utilizing a pooled trust for third party special needs can be a flexible tool for counsel to meet the unique needs of their client by providing a cost effective estate plan which addresses the current or potential needs of a special needs beneficiary. Experience with pooled trusts will allow counsel to make confident recommendations to the client, eliminate some of the hazards associated with family trustees, and

provide an additional planning choice to the traditional third party special needs trust.