

# DEPARTMENT OF TAXATION

## 2011 Fiscal Impact Statement

1. **Patron** David W. Marsden

3. **Committee** Senate Finance

4. **Title** Taxation of trusts established for disabled individuals

2. **Bill Number** SB 1175

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would create an individual income tax deduction for contributions made to a supplemental needs trust, up to \$2,000 per year. This bill would also exclude any income earned by a supplemental needs trust from income taxes.

This bill would be effective for taxable years beginning on or after January 1, 2011.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

### 8. **Fiscal implications:**

#### Administrative Impact

TAX considers implementation of this bill as routine, and does not require additional funding.

#### Revenue Impact

This bill would result in an unknown revenue loss. The purpose of supplemental needs trusts is to benefit individuals with disabilities while allowing them to qualify for Medicaid by keeping their countable assets below the program limit. According to the Virginia Department of Medical Assistance Services, there were 189,536 persons who were blind or who had disabilities in the Medicaid program in FY 2009. The number of these individuals who either have a special needs trust or who would have one if this bill is passed is unknown. Each \$2,000 contribution would reduce income tax revenue by as much as \$115. There would be additional losses resulting from the exclusion of income earned by the trust.

### 9. **Specific agency or political subdivisions affected:**

Department of Taxation

**10. Technical amendment necessary: No.**

**11. Other comments:**

There are income and asset limitations placed on individuals that receive Medicaid and Supplemental Security Income (SSI) benefits. If assets are placed in certain types of trusts for the benefit of a disabled individual, the federal government will exempt these assets when determining eligibility for Medicaid and SSI. Such exempt trusts include (i) disabled individual special needs trusts; (ii) non-profit pooled income special needs trusts; and (iii) third-party supplemental needs trusts.

Disabled Individual's Special Needs Trust

A disabled individual's special needs trust is not counted as a Medicaid asset even if it is funded with the individual's own assets. To qualify for this type of trust, an individual must be under the age of 65 and disabled under the Social Security definition. The trust must be established for the sole benefit of the disabled individual and must be created by a parent, grandparent, legal guardian, or a court. One of the conditions imposed on the trust is that the state will receive all amounts remaining in the trust upon the death of the individual, up to an amount equal to the total medical assistance paid on behalf of the individual under a state Medicaid plan.

A disabled individual may not create his or her own special needs trust, even if he or she is otherwise legally competent. Action by a third party is required to create this type of trust. Special needs trusts are often established by a court on behalf of a disabled person as part of a serious personal injury lawsuit.

Non-Profit Pooled Income Special Needs Trust

A non-profit pooled income special needs trust is a trust that must be established and managed by a non-profit. The individual beneficiary must be disabled under the Social Security definition. In this type of trust, a separate account is maintained for each disabled individual beneficiary, but all accounts are pooled for investment and management purposes. Each account in the trust may be established by a disabled individual; a parent, grandparent, or legal guardian of a disabled individual; or a court. Upon the death of the disabled individual, the balance is either retained in trust for the nonprofit association or paid to the state Medicaid agency in an amount equal to the total amount of medical assistance paid on behalf of the individual.

Third-Party Supplemental Needs Trust

A third-party supplemental needs trust allows third parties to provide assets to disabled individuals without disqualifying the disabled individual from Supplemental Social Security (SSI) or Medicaid benefits. This type of trust must be created by a party other than the disabled individual, must not receive any assets belonging to the beneficiary, and must be restricted (not accessible or available) to the beneficiary. A third party who funds a trust for a disabled individual can reserve the right to later revoke the trust and reacquire the assets.

The operative principle to a third-party supplemental needs trust is whether the trust assets or income are available to the beneficiary. If appropriate trust language is used, Medicaid will not treat the resources in the trust as a countable resource. A third-party supplemental needs trust should not be drafted as a general support trust, nor should it mandate distribution of current income to the beneficiary. Such provisions could cause a trust to be deemed "available" and may disqualify a beneficiary from Medicaid. The Medicaid beneficiary should not be given any power to revoke the trust or direct the trustee to make distributions to the beneficiary.

Typically, a third-party trust provides that the trustee is given unfettered discretion to distribute (or not to distribute) principal or income for the benefit of the disabled beneficiary. The trustee is often directed to only make distributions for the "supplemental" or "special" needs of the beneficiary or to make distributions as long as they do not disqualify the beneficiary from governmental benefits. Frequently the trustee will be specifically prohibited from making distributions which provide the beneficiary with food or shelter, which are the two disqualifying categories under SSI and Medicaid regulations. There is no requirement that the trustee be so restricted. In many cases, it may actually be preferable for the trustee to make distributions which reduce or eliminate public benefits in cases where the availability of trust resources is more important than continue eligibility for SSI and Medicaid.

#### Proposed Legislation

This bill would create an individual income tax deduction for contributions made to a supplemental needs trust, up to \$2,000 per year. This bill would also exclude any income earned by a supplemental needs trust from income taxes.

Three types of trusts that would qualify under this bill include: (i) disabled individual's special needs trusts; (ii) non-profit pooled income special needs trusts; and (iii) third-party supplemental needs trusts, the property of which is not considered a resource for SSI purposes.

This bill would be effective for taxable years beginning on or after January 1, 2011.

#### Similar Legislation

**House Bill 1880** is identical to this bill.

cc : Secretary of Finance

Date: 1/22/2011 KLC  
SB11175F161