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TRUST MODIFICATIONS FOR BENEFICIARIES WITH DISABILITIES

There are times in which traditional estate planning does not achieve the decedent's goals, particularly when a beneficiary has a disability. The most common problem occurs when a decedent leaves money in trust for a beneficiary with a disability that would cause the beneficiary to lose eligibility for needs-based government benefits, such as Medicaid and Supplemental Security Income (SSI). It may be possible to modify the terms of such a trust in order to preserve the beneficiary's eligibility for these benefits. A recent New York case serves as an example of a modification that results in a third-party special needs trust, with no Medicaid payback at the death of the beneficiary.

In Matter of Longhine (2007 N.Y. Slip Op. 50517(U), February 27, 2007), the Wyoming County Surrogate's Court reviewed a testamentary trust for the benefit of the decedent's disabled son, James. The trust provided for the distribution of income and principal to the beneficiary, but the trust was not a supplemental needs trust (SNT). James was receiving SSI, but not Medicaid. James's guardian ad litem filed a petition seeking construction of the will and reformation of the trust to create an SNT for James. The Wyoming County Department of Social Services (DSS) filed an answer objecting to the form of the SNT, because it did not contain a clause that required Medicaid payback upon James's death. The court found that DSS had standing in the proceedings because of the potential that James could receive Medicaid benefits before the trust was exhausted.

The court addressed two issues. First, may the testamentary trust be reformed to create an SNT to preserve James's eligibility for government benefits, and second, must an SNT created by the action of court in reforming the trust contain a "payback clause." New York state law authorizes the Surrogate's Court "to determine the validity, construction or effect of any provision of a will and to take such proof and make such decrees as justice shall require."

Under the terms of the trust as written, the trustee was to pay the income of the trust to James quarterly, and the trustee had the authority to invade the trust principal for James's "health, support and maintenance." The court acknowledged that the terms of the will were clear and unambiguous, and that the trust was a non-SNT trust, but that clear and unambiguous language was not a bar to the reformation of a testamentary trust. The court also acknowledged that if the trust was not reformed, then James would likely lose his eligibility for SSI, and be denied eligibility should he ever apply for Medicaid. The attorney-draftsman submitted an affidavit stating that an SNT was not considered at the time of the drafting of the will because of the decedent's final illness. The affidavit also stated that "had the testator considered James's likely disqualification from the benefits being received, he clearly would have intended that the trust be an SNT." The court reviewed other Surrogate Court opinions and found that three courts allowed reformation of a testamentary trust and creation of a third-party SNT (one court did so in two separate cases), and one that did not. Three of the cases the court cited involved wills executed prior to the existence of statutory authority for the creation of SNTs. The courts in these cases allowed the testators to benefit from a planning device that did not exist at the time the will was executed, and presumed that the planning device would have been used by the testator. In the fourth case the court found intent in the language of the will to supplement rather than to supplant government benefits being received by the beneficiary.

The court stated that reformation may be allowed upon consideration of relevant factors including: (1) The intention of the testator; (2) Lack of fraud or unjust enrichment; and (3) Non-interference with or disruption of the dispositional plan under the instrument. The court cited the principle in the Third Restatement of the Law of Property, "A donative document, though unambiguous, may be reformed to conform the text to the donor's intention if it is established by clear and convincing evidence (1) that a mistake of fact or law, whether in expression or inducement, affected specific terms of the document; and (2) what the donor's intention was."

The court acknowledged that in New York, "courts have created a presumptive intent on the part of the testator or donor to take advantage of public benefits or funds available as the primary means of providing for the care of a disabled individual." The court said that "this common-sense presumption is similar to the presumption that a testator will desire to reduce taxes to the greatest extent possible." The affidavit of the attorney-draftsman stated that the decedent was the sole caregiver for James for James's entire adult life, James was receiving public benefits at the time of the execution of the will, and the bulk of the estate consisted of several parcels of real property. The court said that given these facts, the potential loss of James's government benefits, and the likely need to sell the parcels of real property to replace those benefits, the court had "no difficulty in presuming that the testator would have intended that James' share pass by way of an SNT had he been presented with that option." There was no suggestion of any element of fraud or unjust enrichment, and the creation of the SNT was necessary to preserve the plan established by the will. The court further found that no Medicaid payback clause was required because the will, as reformed, passes the property of the testator, not James, into the SNT, and the trust is therefore not a "self-settled" trust.

Oast & Hook thanks attorney and Special Needs Alliance member Richard A. Kroll of Rochester, New York, for bringing this case to our attention, and providing us with a copy of the court's opinion.

Oast & Hook has been successful with having courts modify trusts to create third-party SNTs, and our attorneys are available to assist clients in this area. There are several Virginia Code sections that are relevant to this process. Virginia Code §55-544.12 permits the court to modify the dispositive terms of a trust if, because of circumstances not anticipated by the settler, modification will further the purposes of the trust. To the extent practicable, the modification shall be made in accordance with the settlor's probable intention. Virginia Code §55-544-11(B) permits a court to modify a noncharitable irrevocable trust by consent of all of the beneficiaries if the court concludes that the modification is not inconsistent with a material purpose of the trust. Virginia Code §55-544.15 permits a court to reform the terms of a trust, even if unambiguous, to correct mistakes. A trustee or beneficiary may proceed under Virginia Code §55-544.10 to maintain a proceeding to modify a trust.

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