

SPECIAL NEEDS ALLIANCE

BEGLEY & BOOKBINDER is a member of the **SPECIAL NEEDS ALLIANCE**, which is composed of leading law firms throughout in the country focusing in the area of Special Needs Trusts. We have resources across the country to whom to refer our clients and we attend two cutting-edge educational programs each year where attendance is restricted to Alliance members. Visit the Special Needs Alliance website at www.specialneedsalliance.com or call (877) 572-8472.

Services provided:

- Legal
 - Counsel on settlement terms
 - Trust drafting and approval
 - Estate planning for the family
- Trustee Services
 - Serve as trustee
 - Educate beneficiary and family
 - Provide trust accountings
 - Prepare and file tax returns
- Financial Services - Arrange for professional money management
- Care Management - Arrange for care managers where appropriate

Special Needs Trusts for Litigation Proceeds

Things to think about



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THE PROBLEM

If an award from a personal injury case is paid to a plaintiff receiving certain public benefits, that person will lose those benefits. Frequently the award will be exhausted quickly to pay for medical expenses that otherwise would have been paid by Medicaid. The plaintiff then would have no other means of support to meet his or her needs. A personal injury lawyer may be liable for malpractice and may also be guilty of an ethics violation.

THE SOLUTION

In 1993 Congress authorized the establishment of Self-Settled Special Needs Trusts for this situation. The award is placed in the trust and the trustee uses the funds for the disabled plaintiff's special needs and the plaintiff's public benefits, particularly SSI and Medicaid, are protected. The trust can provide for expert money management by a professional money manager, and appropriate care for the disabled person utilizing care managers, if appropriate. The life of the disabled person is enriched.

IS A SPECIAL NEEDS TRUST ALWAYS APPROPRIATE?

A Special Needs Trust is not always appropriate. The advantage of the Special Needs Trust is that the funds in the trust can be used for the disabled person and public benefits, particularly SSI and Medicaid can be preserved. However, a disabled person loses control of those funds. Cash cannot be paid directly to the beneficiary. The trustee must pay for goods and services directly to third parties.

In many situations where the proceeds are relatively small, other Medicaid planning techniques may be available to avoid establishment of a trust. In other situations if no *means-tested* public benefits are being received or are likely to be received, then a trust may be unnecessary.

Can the trustee make gifts from the trust to persons other than the disabled person?

No. Federal and state law require that the trust be "for the sole benefit" of the disabled person. Distributions to anyone other than the disabled person are prohibited. Anyone benefiting from a distribution from a Special Needs Trust must pay his or her pro rata share.

Can a trust own a home?

Yes. A trust may own a home. The problem is that when the disabled person dies the home will be subject to the payback provision to repay Medicaid and the home may be lost. Before deciding whether the trust should purchase a home, Begley & Bookbinder can give advice as to this option compared to other options. In some cases trust ownership of a home is avoidable and in other cases it is not.

May the trust pay the beneficiary's rent?

Yes. The trust may pay the beneficiary's rent. However, since this is a payment for shelter, the SSI payment will be reduced by one-third or one-third plus \$20 depending on the living arrangements of the disabled person. Medicaid will not be affected.

May trust funds be used to supplement the salaries of caregivers paid for by Medicaid?

No. The trust funds cannot be used to supplement the salaries of caregivers paid for by Medicaid, but the trust funds can be used to provide for additional hours. Under CCPED in New Jersey it is difficult to get more than 20 hours per week paid by Medicaid. The trust could pay for additional hours if they are required.

Can the trust make payments to family caregivers?

Under New Jersey Medicaid Regulations a payment cannot be made to a family member to discharge a legal obligation of support. If the care provided for the parent is not deemed to be a legal obligation of support, then payments to family caregivers are permitted. For example, if the disabled person were over the age of 18, the legal obligation of support generally ends and such payments would be appropriate.

Is there interest on the lien upon the beneficiary's death?

No. There is no interest due to Medicaid upon the death of the disabled person. Only the amount of money actually expended by Medicaid must be repaid. Essentially this amounts to an interest-free loan. Additionally, since Medicaid pays much less for services than a person would pay privately, there is a discount involved.

Must SSI payments be repaid by the trust upon the death of the beneficiary?

No. Only Medicaid must be repaid from the trust. Payments made by SSI, SSD or Medicare do not need to be repaid.

FREQUENTLY ASKED QUESTIONS ABOUT SPECIAL NEEDS TRUSTS

Should every disabled person have a Litigation Special Needs Trust?

No. Some persons are not receiving public benefits that require a Special Needs Trust and are not likely to receive such benefits in the future. If the amount of the Special Needs Trust is small, there may be other ways of accomplishing Medicaid and SSI eligibility without the necessity of a Special Needs Trust. Begley & Bookbinder can advise with respect to these options.

Must the Beneficiary always remain on benefits?

No. Special Needs Trusts can be terminated if the disabled person regains independence. Medicaid must be repaid for monies they have advanced from the inception of the trust. Any remaining assets in the trust can be distributed to the formerly disabled person.

Can a disabled person serve as trustee?

No. The disabled person cannot have any power to direct trust disbursements. This would make the funds in the trust available for public benefit purposes.

Who can serve as trustee?

While anyone other than the disabled person can serve as trustee it is desirable to have a professional who is familiar with the administration of Special Needs Trusts fills this role. As a general rule family members do not have the expertise to manage these trusts and often unintentionally abuse them and disqualify the beneficiaries from their public benefits.

What can the trust pay for?

Distributions should be made for the disabled person's special needs, such as transportation, education, telephone, medications and treatments not provided for by Medicaid and other items designed to enhance the quality of the disabled person's life. However, if distributions are made for food, clothing or shelter, there will be a reduction in the disabled person's SSI payment.

What happens if a Special Needs Trust does pay for food, clothing and shelter?

If the Special Needs Trust pays for food, clothing or shelter, the SSI payment is reduced by one-third or one-third plus \$20 per month depending on the disabled person's living arrangements. However, the basic benefit is preserved and Medicaid is preserved.

FEDERAL AND STATE LAW

FEDERAL LAW

Special Needs Trusts are authorized at 42 U.S.C. § 1396p(d)(4)(A). The requirements are as follows:

- The trust must be funded with assets of the individual (the award).
- The individual must be under 65 years of age at the time the trust is funded.
- The individual must be disabled.
- The trust must be "for the sole benefit of" the disabled beneficiary.
- Other persons benefiting from the trust must pay their pro rata share of expenses (i.e., a home).
- The trust must be established by a parent, grandparent, legal guardian or a court.
- The state paid that paid medical assistance on behalf of the individual must be reimbursed upon death.
- Reimbursement must be made up to an amount equal to the total medical assistance paid on behalf of the individual.

The Foster Care Independence Act of 1999 spells out additional provision pertaining to the establishment and administration of these trusts.

If the plaintiff is receiving SSI, the Social Security Administration must approve the trust.

NEW JERSEY STATE LAW

In 2000 the Division of Medical Assistance and Health Services (DMAHS) promulgated regulations pertaining to the drafting and administration of Special Needs Trusts in New Jersey. These regulations are extremely detailed. Some of the significant provisions include:

- Notice of the settlement must be given to the Director of DMAHS.
- Any persons benefiting from trust expenditures must pay their pro rata share. For example, if the trust buys a home, other family members must contribute their share toward the operating expenses.
- Trustees must be bonded unless the bond is waived by the court.
- Trust funds cannot be used to discharge a legal obligation of support of a parent.
- The Trust must contain specific provisions outlined in the New Jersey Medicaid Regulations.

Trusts must be approved by the State Medicaid Agency.

ADMINISTRATION OF A SPECIAL NEEDS TRUST

The administration of a Special Needs Trust is governed by the Foster Care Independence Act of 1999, the Program Operating Manual System of the Social Security Administration (POMS), and the Amendments to the New Jersey Medicaid Regulations adopted in 2000. Significant considerations in drafting Special Needs Trusts include the following:

- Distributions cannot be made to the disabled person.
- Distributions must be made directly to third parties for the disabled person's special needs.
- Distributions in-kind of food, clothing and shelter reduce the disabled person's SSI benefit, but do not eliminate it.
- Trust assets must be titled in the name of the trust.
- A bond is required unless waived by the court.
- Accountings are required.
- The trustee must comply with the Prudent Investor Act.
- Accurate records must be maintained.
- If the disabled person is receiving SSI, reports must be made to the Social Security Administration.
- There are special rules pertaining to homes and motor vehicles.
- DMAHS must be given 45 days advance notice of any distribution in excess of \$5,000.

MEDICAID

Medicaid eligibility is usually met by qualifying for SSI. In New Jersey a person receiving SSI is automatically entitled to Medicaid. There are some exceptions to this general rule. Medicaid is often the most important public benefit the disabled person receives, because it pays the person's medical bills. Medicaid provides:

- Medical services and treatments
- Prescriptions
- Hospitalization (including nursing care)
- Psychiatric care and dental care
- "Medically necessary" durable medical equipment
- Long-term nursing home care

COMMUNITY-BASED SERVICES

New Jersey has waiver programs under which Medicaid will provide in-home services for disabled persons receiving SSI and Medicaid so that they can avoid nursing home placement. Disabled persons would always prefer to remain home and this is a significant advantage.

SOCIAL SECURITY DISABILITY (SSD)

SSD is an entitlement program paid for through Social Security taxes. Because it is an insurance program, it is not means-tested. Eligibility is based on the work history and the amount of benefits is based on prior earnings. To be eligible the beneficiary may not be able to engage in any *substantial gainful* activity, as defined in the Social Security Act.

MEDICARE

Medicare is a federal medical insurance program for people over 65 and people under 65 who are disabled for two or more years.

BENEFIT COMBINATIONS

Some persons are eligible for SSI and SSD and Medicaid and Medicare.

PUBLIC BENEFIT PROGRAMS

Disabled persons usually receive either a combination of Supplemental Security Income (SSI) and Medicaid or Social Security Disability (SSD) and Medicare. SSI and SSD are both income assistance programs. Medicaid and Medicare are medical payment programs. Both SSI and Medicaid are means-tested programs, which means that there are limit in the income and assets that the disabled person may have. SSD and Medicare are insurance programs. These are not means-tested. They have no income or asset limits.

If a beneficiary is receiving SSD and Medicare and never expects to require any monies paid by Medicaid, or group housing, vocational training, etc. and never expects to need Section 8 Housing or any other means-tested public benefit programs, Special Needs Trust may not be appropriate. If the disabled person is receiving SSI and Medicaid, a Special Needs Trust is required unless there can be another way to achieving Medicaid spend down. Generally speaking the SSI/Medicaid recipient can have very limited income and the following assets:

- \$2,000 in liquid assets
- \$2,000 in household goods
- A residence occupied by the disabled person
- One automobile
- A term life insurance policy or a prepaid funeral in an irrevocable funeral trust.

If distributions of cash are made to an SSI beneficiary, this will cause a dollar-for-dollar reduction in benefits. If the SSI benefit is reduced to zero, the disabled person loses SSI and Medicaid. If a Special Needs Trust pays directly for goods and services, there is no reduction in SSI benefits unless the services are for food, clothing and shelter in which event there is a reduction but not a loss of benefits. As long as the SSI benefits are not completely lost, Medicaid will be maintained. If the trustee of the Special Needs Trust makes improper distributions, both SSI and Medicaid can be lost.

LIENS ARISING FROM THE INJURY

Federal and state law require that payments made by Medicaid and/or Medicare in connection with treatment of the injury which gave rise to the lawsuit must be reimbursed to the state Medicaid agency or Medicare, respectively, before the remaining funds can be paid to the Special Needs Trust or to the plaintiff directly. It is becoming increasingly difficult to compromise these liens unless there is an issue as to liability. If a worker's compensation claim is settled for a lump sum, the Medicare Secondary Payer Act requires that a sum sufficient to pay anticipated future medical bills be set aside in a Medicare Set-Aside Arrangement.

PAYBACK PROVISIONS

Both federal and state law require that the trust document contain a payback provision whereby the state Medicaid agency will be repaid any funds expended on behalf of the disabled person during the term of the trust. This payback is made upon the death of the disabled person. Additional monies remaining in the trust may be distributed to persons designated by the disabled person or his heirs in law or next of kin. If all funds in the trust are expended for the disabled person during his lifetime, the state is not entitled to a recovery. If the beneficiary has other assets outside the trust, such as a home, they may be subject to a separate lien. This risk may be minimized with advice from an attorney familiar with Medicaid.

TAXES, STRUCTURED SETTLEMENT ANNUITIES AND SPECIAL NEEDS TRUSTS

TAXATION OF A PERSONAL INJURY AWARD

Under current federal tax law, most payments received as the result of a personal injury are not included as gross income. Awards attributable to lost wages or punitive damages are exceptions and are subject to taxation.

STRUCTURED SETTLEMENT

A structured settlement annuity is a payment of money for a personal injury on a periodic payment basis over a period of time. The time can be the life of the disabled person, a fixed term of years, or a combination of both. Structured settlements are regulated by both federal and state law.

TAXATION OF STRUCTURED SETTLEMENT PAYMENTS

Provided certain guidelines are met the income received from the structured settlement is tax-free to the disabled person. This includes the interest component of each payment. However, unpaid installments are included in the disabled person's estate for federal estate tax purposes.

ADVANTAGES AND DISADVANTAGES OF STRUCTURED SETTLEMENTS

Budgeting. Studies have shown that the average personal injury claimant spends the entire lump sum settlement within five years. The structured settlement can guarantee that the monies last a lifetime.

Taxes. If the beneficiary receives a lump sum payment, the income earned by the lump sum is taxable to the trust or the disabled beneficiary. The income component of the payment under a structured settlement is tax-free. However, to the extent monies are paid from the lump sum for medical purposes, there is an offsetting medical deduction.

Flexibility. Monies paid under a structured settlement are not available to pay unexpected expenses based on a change in circumstance. Designing a life care plan and allocating a portion of the settlement to a lump sum and a portion to a structure will often solve this problem.

SELECTION OF THE TRUSTEE

Under federal law the funds in a Special Needs Trust are not considered available to the disabled person for purposes of determining eligibility for SSI and Medicaid. The key is that the trustee must have complete discretion as to distributions. The disabled person must not have the right to compel a distribution for support and maintenance or to revoke the trust.

The selection of a trustee is crucial for the successful administration of the trust. Unless the trust is administered properly, funds will be exhausted prematurely and/or the disabled person may lose his public benefits. The ideal trustee should:

- Understand public benefits law
- Understand the Prudent Investor Act and the Income and Principal Accounting Act
- Understand federal and state tax law
- Keep accurate books and records
- Be bondable
- Live at least as long as the disabled person will live
- Have the best interest of the disabled person at heart

The solution is often to have co-trustees with a professional trustee and a family member serving as co-trustees. Attorneys at Begley & Bookbinder are often willing to serve as trustees of Special Needs Trusts. They are also willing and able to help locate corporate trustees to fill these roles.