

Using Public Benefits to Pay for Matrimonial Settlements

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Issues relating to public benefits for the elderly and disabled have not been widely examined in the context of marital dissolution. By utilizing public benefits to the advantage of their clients, matrimonial attorneys may be in a position to achieve a more favorable settlement for their clients. According to *Business Week* one in ten American families has a disabled person. The presence of a disabled spouse or child often exerts unbearable stress on a marriage and causes it to fall apart. This article will discuss the available public benefits as well as the effect of equitable distribution, alimony and child support on the disabled divorcing parties and also on the disabled children. By taking advantage of available public benefits the amounts necessary from private funds may be minimized and an agreement to dissolve the marriage may be more easily achieved.

1. CASE STUDIES

1.1. Disabled Spouse – Case Study #1 – No Public Benefits

Bill and Linda are in their mid-30s. Linda has contracted Multiple Sclerosis. Bill and Linda have decided to divorce. Linda is unable to work because of her disability. She wants alimony and equitable distribution. Linda's attorney succeeds in having Bill pay Linda \$500,000 lump sum as equitable distribution and proposes \$2,500 per month alimony. However, Linda requires a home health aide for approximately 20 hours per week at a cost of \$1,540 per month and her other medical bills are approximately \$3,000 per month and she will soon lose her medical coverage under Bill's policy. Linda is concerned that her medical bills will consume her share of the equitable distribution. Linda demands \$7,000 per month alimony. The case drags on at increasing cost and bitterness for both sides.

1.2. Disabled Spouse – Case Study #2 – Public Benefits

Harry and Sally are in their mid-30s. Sally has contracted Multiple Sclerosis. Harry and Sally have decided to divorce. Sally is unable to work because of her disability. She wants alimony and equitable distribution. Sally's attorney succeeds in having Harry pay Sally \$500,000 lump sum as equitable distribution and Harry's attorney proposes \$2,500 per month alimony. Sally will require approximately 20 hours per week of home care at a cost of \$1,540 per month. Sally's other medical bills are approximately \$3,000 per month and she will soon lose her medical coverage under Harry's policy.

Harry's attorney, working with a special needs trust attorney as consultant, arranges for the equitable distribution and alimony to be paid into a special needs trust. The lawyer drafting the trust was a member of the *Special Needs Alliance*. As a result, Sally became entitled to SSI paying her approximately \$600 per month, and Medicaid which pays her medical bills. Medicaid also pays for a home health aide to come to

Sally's home for 20 hours per week. Medicaid also pays Sally's other medical bills. The trustee of the Special Needs Trust uses the alimony to pay for that portion of Sally's living expenses that exceed the amount of her SSI payment. The trustee makes payments directly to the providers of goods and services rather than to Sally. The payment of equitable distribution does not have to be used for Sally's medical bills.

When equitable distribution is paid directly to the trustee of a self-settled special needs trust the assets in the trust are not countable to the disabled person for purposes of determining public benefits eligibility. Where alimony is paid into a self-settled special needs trust it is not considered income to the disabled person for determining public benefits eligibility.

2. WHEN IS A SPECIAL NEEDS TRUST REQUIRED?

A Self-Settled Special Needs Trust is required for a disabled person if the person is currently receiving SSI, Medicaid, Section 8 Housing, certain types of state disability benefits or benefits under any other means-tested program, or if the person is likely to receive such benefits in the future.

Assets held in a properly-drafted special needs trust are not available for purposes of determining public benefits eligibility. These trusts were authorized by Congress¹ and by the State of New Jersey.² They are also governed by the New Jersey Medicaid Regulations.³ These trusts are called self-settled trusts, because usually the money used to fund the trust belongs to the disabled person. For example, if a couple divorced and a disabled spouse was receiving equitable distribution, the assets comprising the equitable distribution would belong to the divorcing disabled spouse and could, therefore, be placed in a self-settled special needs trust.

2.1. Basic Requirements

There are five basic requirements for a self-settled special needs trust:

- *Assets of the Individual.* The trust must be funded with assets of the individual, including equitable distribution or alimony.
- *Age.* The individual must be under 65 years of age at the time the trust is funded.
- *Disabled.* The individual must be disabled as defined in the Social Security Act.
- *Establishment.* The trust must be established by a parent, grandparent, guardian, or a court.

¹ 42 U.S.C. § 1396p(d)(4)(A).

² N.J.S.A. 3B:11-36.

³ N.J.A.C. 10:71-4.11.

- *Payback.* The state Medicaid agency must be reimbursed upon the death of the disabled person.

In addition, the trust must give the trustee discretionary authority to make distributions and the trust must be irrevocable.

2.2. What Can the Trust Pay For?

The trust can pay for a very broad range of goods and services as long as payment is made directly to the provider rather than to the disabled person. Examples include personal effects such as appliances, computers, automobile, rent, home improvements, pools, utilities, medical insurance, newspaper subscriptions, furniture, services of a care manager, federal and state taxes, funeral and legal fees. Payments for food and shelter are likely to reduce the SSI payment by one-third or one-third plus \$20 depending on living arrangements.

Trusts can purchase homes and vehicles, but these are considered special assets. While they are non-countable assets, there are a number of options that must be considered in consultation with the special needs lawyer assisting in the case to ensure that the assets are properly titled.

Generally, funds in the Self-Settled Special Needs Trust can only be used for the benefit of the disabled person. Other family members or friends benefiting from the trust are usually required to pay a pro rata share for their benefit. Trust assets are usually not permitted to be used to discharge a parent's legal obligation of support.

2.3. How is the Trust Established and Funded?

Federal Law requires that the trust be established by a parent, a grandparent, a guardian, or a court. The trust cannot be established by the disabled person. The trust is funded by having the court order the defendant to pay the lump sum by check directly to the trustee of the Self-Settled Special Needs Trust. If a structured settlement is involved, the court must also order that the monthly payments from the structure are also paid by check directly to the trustee of the Self-Settled Special Needs Trust. If payments are made to the personal injury attorney, this constitutes "constructive receipt." This means that for public benefit purposes the agency will consider that the money in the attorney's trust account is available to the disabled person and public benefits will be lost.

2.4. Agency Approvals.

- *SSA.* If the disabled person is receiving SSI, the Self-Settled Special Needs Trust will require approval by the Social Security Administration.

- *Medicaid.* If the disabled person is receiving Medicaid, the trust will require approval by the State Medicaid Agency.

- *Filing.* The special needs attorney is generally responsible for filing the notices and copies of the trust document with the Social Security Administration and/or State Medicaid Agency. It is important to show SSA and the State Medicaid Agency exactly how the trust document complies with their requirements. It should be done by separate cover letter. The agencies seldom respond specifically approving the trust, but it is very important to file the notice with the agencies. If SSA or the State Medicaid Agency do not approve the trust, they will respond with the reasons why.

3. IN WHAT SITUATIONS IN A MATRIMONIAL CONTEXT SHOULD A SPECIAL NEEDS TRUST BE UTILIZED?

By accessing public benefits the amount of money required from the non-disabled divorcing spouse can be reduced while the benefit to the disabled spouse can be increased. Cases are easier to settle, because public benefits are filling some of the need.

3.1. Using A Special Needs Trust For Equitable Distribution

Equitable distribution is a division of the marital assets. If one of the divorcing spouses is disabled, the existence of the equitable distribution will prevent that person from accessing public benefits and will cause a loss of any existing public benefits. The solution is to have the equitable distribution paid in to a Self-Settled Special Needs Trust for the benefit of the disabled spouse.

3.2. Using A Special Needs Trust For Alimony

Payment from one spouse to a disabled spouse for maintenance and support during legal separation and/or after the divorce is finalized results in the alimony payments being counted as income to the disabled spouse for SSI eligibility purposes. The alimony reduces the SSI payment dollar-for-dollar and if the alimony completely eliminates the SSI, not only is the SSI lost but the accompanying Medicaid is lost as well. The solution is to establish a Self-Settled Special Needs Trust and have the court direct payments to the trustee of the Special Needs Trust rather than directly to the disabled spouse.

3.3. Using A Special Needs Trust For Child Support

Payment of child support to a child is income to that child. For SSI purposes, one-third of the support payment is excluded from the child's countable income. However, the remaining two-thirds of the support payment reduces the child's SSI payment dollar-for-dollar. If the payment is reduced to \$0, the child will lose not only SSI but also the accompanying Medicaid. By paying the child support directly into a Self-Settled Special Needs Trust, the income is not counted to the child and public benefits can be maintained. Social Security claims officers have been inconsistent as to whether a Self-Settled Special Needs Trust can be used for child support.

The converse issue is whether assets in a Self-Settled Special Needs Trust for a disabled person can be reached to enforce a child support order. Assets in the Self-Settled Special Needs Trust must be for the *sole benefit* of the disabled person. While there are no court rulings, there are a number of cases where it has been argued that payment of a child support order is a proper distribution from a Self-Settled Special Needs Trust, because it is for the sole benefit of the disabled person since that person avoids contempt of court and possibly jail. Self-settled trusts are not exempt from claims of creditors unless they are established in a state having legislation authorizing domestic asset protection trusts.⁴

A third issue arising in situations where there is a Self-Settled Special Needs Trust for child support is whether those assets are available for the support of the child when determining the parent's obligation of support. A Missouri case has held that they are not available for purposes of child support and that the court determining the level of child support should not take those assets into consideration when determining the parent's obligation of support.⁵

4. REQUIREMENTS OF A SELF-SETTLED SPECIAL NEEDS TRUST

Self-Settled Special Needs Trusts are authorized by Congress, but there are certain requirements:

- *Assets of the Individual.* The trust must be funded with assets of the individual. Litigation proceeds are considered assets of the individual.
- *Age.* The individual must be under 65 years of age at the time the trust is funded.
- *Disabled.* The individual must be disabled as defined in the Social Security Act.
- *Establishment.* The trust must be established by a parent, grandparent, guardian, or a court.
- *Payback.* The state Medicaid agency must be reimbursed upon the death of the disabled person.

In addition, the trust must give the trustee discretionary authority to make distributions and the trust must be irrevocable.

5. PUBLIC BENEFITS

There are a number of public benefits available to disabled persons.

⁴ Alaska, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, and Utah.

⁵ *Louis v. Dept. of Soc. Servs.* 61 S.W. 3d 248 (Mo. 2001).

- *SSI*. SSI is an income maintenance program under which the federal government pays \$579 per month to a single disabled person and \$869.00 per month to a married couple. In addition, there is a small state supplement. SSI is a means-tested program. Both income and assets are restricted. Persons having more than \$2,000 of countable assets are ineligible for SSI. As a general rule, receipt of income reduces the SSI payment dollar-for-dollar.

- *Medicaid*. Medicaid is a medical payment program. In New Jersey persons receiving SSI are automatically eligible for Medicaid. If a person loses SSI because of equitable distribution, alimony or child support, that person also loses their Medicaid.

- *SSD*. SSD is also an income maintenance program provided by the Social Security Administration. However, it is an insurance-based program. Working people pay into the system, and if they become disabled they are entitled to receive a monthly benefit based on their work record. Certain children of retired or deceased parents are entitled to SSD based on their parent's work record. This is not a means-tested program.

- *Medicare*. Medicare is a medical insurance program. Two years after a determination of disability a person is eligible for Medicare. This is not a means-tested program. However, Medicare has a number of deductibles, copayments and maximums. While payments to providers are larger and more providers will accept Medicare than Medicaid, coverage under Medicare is not as broad as coverage under Medicaid.

- *Section 8 Housing*. Section 8 Housing is a program whereby persons meeting an income test of between 50% and 80% of the regional maximum established by the Department of Housing and Urban Development (HUD) are eligible for rent supplements. Typically, the public housing resident pays approximately 30% of his or her income for rent and the federal government pays the difference. This is a means-tested program. Eligibility is based on income. Assets are not considered except that actual income from assets is considered, and if assets produce no income, then interest is imputed. This is added to the applicant's income for purposes of determining eligibility and the amount of rent to be paid.

- *DDD Benefits*. The Division of Developmental Disabilities provides a number of benefits to developmentally disabled persons. These benefits could include group homes, vocational training and care services. Many DDD programs have cost-sharing requirements based on the ability to pay of the disabled person or their family.

- *Other Public Benefits*. There are a number of other public benefits, such as general assistance, prescription benefits, psychiatric services (including institutionalization), and food stamps, that are means-tested.

6. USING A STRUCTURED SETTLEMENT IN A DIVORCE SITUATION

6.1. Advantages of a Structure

There are several features of structured settlements that should be understood:

- *Present Value.* A divorcing spouse purchasing a structured settlement annuity for the benefit of the disabled spouse pays for the annuity based on its present value. The insurance company is responsible for investing the money and making future payments.

- *Rated Age.* Many disabled persons have a rated age. This means that an insurance company feels that the disabled person is physically much older than her actual age and has a shorter life expectancy as a result of the disability. Therefore, a lifetime annuity can be purchased based on a shorter life expectancy, thereby significantly increasing the monthly payment. Because of the rated age the cost to purchase the annuity is much lower than it would be for a lump sum for equitable distribution. It would also be much cheaper to purchase the structure with a lump sum instead of alimony. Again, the payment would be based on the rated age rather than the actual age and the insurance company assume the risk that the disabled person will outlive the life expectancy based on rated age.

- *Preservation.* The average divorce settlement, like the average lottery winning, lasts five years. What the disabled spouse usually needs most is an income and medical benefits. By utilizing a self-settled special needs trust and having the healthy spouse buy a structured settlement for the disabled spouse and having payments from the structure paid directly to the self-settled special needs trust, the disabled spouse is able to maintain public benefits and often increase monthly income. By obtaining a structured settlement the plaintiff can be guaranteed a monthly income for life with a fixed period guaranteed even if the disabled person dies.

6.2. Marital Situations

Utilizing a structured settlement in a divorce situation is a creative method that often leads to an excellent result.

There are several situations where a structured settlement makes sense:

- *Equitable Distribution.* By funding the obligation of equitable distribution in whole or in part with a structured settlement, the person paying the equitable distribution will save money if the disabled spouse has a rated age. The disabled spouse will be guaranteed that the money will last his or her lifetime.

- *Alimony.* A structured settlement is perfect for alimony payments. Again, the person paying the alimony saves money by buying a structured annuity, especially if the disabled spouse has a rated age, and the disabled person is guaranteed a

steady stream of income for life paid directly from an insurance company rather than a resentful ex-spouse. In fact, the disabled person may receive a larger monthly payment under the structure at no additional cost to the spouse paying the alimony.

- *Child Support.* Normally the obligation for child support ends at 18. However, where there is a disabled child it may be possible to have the court extend the order for the life of the disabled child. In some situations life insurance is used to fund the needs of the disabled child after the parent's death. A structured settlement may do an even better job by funding the child's needs during the parent's lifetime and after death. Again, the magic of the rated age may result in a discounted cost.

6.3. Features to Consider in a Structure

- *Cost of Living.* Over time with cost of living increases the purchasing power of a dollar declines. Structures can be designed to include a cost of living feature. Historically, the cost of living increases 3% per year, so a structure with a 3% COLA compounded makes sense.

- *POPs.* POPs means that at certain stages of the disabled person's life additional lump sums will be paid out. For example, if the disabled person is likely to go to college, then at age 18 a significant lump sum could be paid to cover college tuition.

- *Commutation Rider.* If the settlement is large and the disabled person dies, there may be federal and/or state estate tax due. The structure should include a commutation rider so that monies are available to pay these taxes if necessary.

7. HOW SHOULD THE MONEY BE INVESTED?

Any money, other than the structure, should be invested in accordance with the Prudent Investor Act. This means that investments should be for Total Return. There should be a written Investment Policy Statement defining the disabled person's tolerance for risk and their investment objectives.

8. SELECTING THE TRUSTEE

Typically family members want to serve as trustee of the Self-Settled Special Needs Trust. The problem is that the family member normally lacks the experience and expertise that is necessary. The trustee must have expertise in the following areas at a minimum:

- Uniform Prudent Investment Act
- Principal and Income Accounting Act
- Public Benefits Laws

Family trustees almost never have this expertise. A better solution is to have a professional trustee. In those situations the family member can serve as co-trustee or

trust protector, or a trust advisory committee can be appointed, including a parent, a lawyer, an accountant, a social worker, and, perhaps a sibling. The trust advisory committee would advise the trustee with respect to distributions.

9. COUNSELING SESSION

It is wise to have a counseling session with the disabled person, the trustee and other interested family members. The disabled person and/or family should prepare a budget and the family and the trustee should agree upon the items in the budget that will be paid by the trustee, what items will be paid by the disabled person and what items, if anything, can be purchased through use of a credit card that will ultimately be paid by the trustee.

It is also important to do a Monte Carlo Simulation. A Monte Carlo Simulation is a way to determine how long the trust will last assuming certain expenses and certain investment returns. Once it is understood that the trust should last the lifetime of the disabled person and a Monte Carlo Simulation shows the likelihood of how long the trust will actually last assuming certain expenditures, the disabled person and/or family often agree to reduce expenditures to a more appropriate level.

At the counseling session the special needs attorney reviews with the trustee, the family and the disabled person the state law requirements pertaining to the administration of a self-settled special needs trust. At the end of the session everyone should understand the rules and a game plan will have been adopted so that the disabled person can receive maximum benefits from the trust during his or her lifetime.

10. ESTATE PLANNING DOCUMENTS/DISABLED PERSON

If the disabled person is a competent adult, he should consider executing a Will, Advance Medical Directive/Living Will and Durable Power of Attorney. The disabled person may have assets in his or her name, such as a home, motor vehicle, and personal effects. Everyone needs an Advance Medical Directive/ Living Will to avoid a Terri Schiavo-type situation, and a Durable Power of Attorney will be extremely helpful if the disabled person become incapacitated and is unable to take certain actions on his or her own behalf.

11. ESTATE PLANNING DOCUMENTS/FAMILY MEMBERS

If there are family members of the disabled person who intend to leave money to or for the benefit of the disabled person, they should have a Will, Advance Medical Directive/Living Will, Durable Power of Attorney and Third Party Special Needs Trust. If a family member leaves money to the disabled person, public benefits will be lost. Family members should not leave money to the Self-Settled Special Needs Trust, because that trust contains a Medicaid payback requirement. The Third Party Special Needs Trust can be used to maintain the public benefits being received by the disabled person. It operates in much the same way as a Self-Settled Special Needs Trust except that there is

no Medicaid payback and no Medicaid accounting requirements. A special needs attorney should be consulted to prepare the Third Party Special Needs Trust. It is also important that all beneficiary designations be coordinated with the family member's estate plan.

12. CONCLUSION

Matrimonial attorneys can better serve their clients by understanding public benefits, by retaining special needs attorneys, particularly experts belonging to the *Special Needs Alliance* (www.specialneedsalliance.com) to counsel the parties pertaining to how Special Needs Trusts might be used to access public benefits, thereby requiring fewer private dollars to accomplish the goals of the parties to the matrimonial action. By utilizing a properly drafted Special Needs Trust means-tested public benefits can be accessed. In a traditional settlement public benefits cannot be accessed until equitable distribution is exhausted, and then only if alimony is very low.