

# SPECIAL REPORT

## Utilizing Special Needs Trusts for Disabled Persons With Litigation Proceeds

### CASE STUDY 1:

#### A personal injury settlement - public benefits lost

John suffered a disabling brain injury as a result of an automobile accident. Initially, he received SSI as well as Medicaid. His medical costs of approximately \$7,700 a month were completely covered by Medicaid.

Upon settling his lawsuit, John received \$500,000 in net proceeds. He immediately lost his SSI and Medicaid because he had more than \$2,000 in countable assets. John began paying for services out of his own pocket at the rate of \$7,700 per month, using up his entire \$500,000 in 64 months. John then reapplied for SSI and Medicaid. He received SSI immediately, but since there were a limited number of slots for his type of Medicaid waiver, he was put on a waiting list and told that it would likely be two or three years before he received a slot. In the meantime, John's medical services stopped.

### CASE STUDY 2:

#### A personal injury settlement - public benefits retained

Bill suffered a serious head injury in an automobile accident, which left him disabled and unable to work. He receives SSI and Medicaid. His life care planner estimates that the cost of a possible recovery will be approximately \$6 million. Bill recently settled his lawsuit for \$3 million. He had been living in Section 8 housing but decided to use some of his settlement to buy a new home and a handicap accessible van and to pay off outstanding debt. These items totaled \$300,000. Bill took another \$200,000 as a lump sum to set aside for emergencies and decided to structure the remaining \$2.5 million. Because Bill had a high rated age as a result of his injury, the insurance company will pay him \$6,000 a month for life with a 20-year guarantee.

Both the lump sum and the structure were paid to the trustee of a Self-Settled Special Needs Trust, which Bill's personal injury attorney prepared in consultation with a lawyer who specializes in elder and disability law. As a result, Bill maintained his SSI, and Medicaid will continue to pay for the extensive therapy he will need for maximum restoration. The monies that Bill receives from the Special Needs Trust will be used to enrich his life, providing for a caregiver, travel and other goods and services Bill otherwise would not be able to afford.

# UNDERSTANDING SELF-SETTLED SPECIAL NEEDS TRUSTS

If you have clients receiving lump sum and/or structured settlements who would otherwise be eligible for means-tested public benefits, it is important to understand the use of Self-Settled Special Needs Trusts to preserve public benefits entitlements and provide a means of enhancing quality of life.

## WHEN IS A SELF-SETTLED SPECIAL NEEDS TRUST REQUIRED?

A Self-Settled Special Needs Trust is required if a person with disabilities currently receives - or is likely to receive in the future - SSI, Medicaid, Section 8 housing, certain types of state disability benefits or benefits under any other means-tested program, and is about to receive a settlement or other monies that will bring the person's countable assets to more than \$2,000. There are four alternatives to establishing a Self-Settled Special Needs Trust:

**ACCEPT THE MONEY.** The person with disabilities will lose public benefits, but if the amount is large enough or the likelihood of requiring expensive medical treatment is small enough, this could be considered.

**TRANSFER THE MONEY TO FAMILY MEMBERS.** The transfer of the funds will disqualify the person with disabilities from receiving public benefits for a period of time, depending on the amount of the transfer. If the amount is large enough and the person does not need means-tested public benefits for the period of time for which he or she will be ineligible, this could be considered.

**SPEND THE MONEY.** If a settlement is small, this option often makes the most sense. Examples of how monies could be expended include repayment of debt and purchase of a home, a car, furniture, appliances, etc. A special needs attorney should be consulted to design a spend-down plan.

**PLACE THE MONEY IN A POOLED TRUST.** If a settlement is small and spend down is not a viable option, it may be more practical to place the litigation proceeds in a pooled trust. Pooled trusts vary in regard to the amount of attention provided individual beneficiaries.

## WHAT ARE THE REQUIREMENTS OF A SELF-SETTLED SPECIAL NEEDS TRUST?

**ASSETS OF THE INDIVIDUAL.** The trust must be funded with assets owned by the individual, such as litigation proceeds.

**AGE.** The individual must be under 65 years of age at the time the trust is funded.

**DISABILITY.** The individual must be disabled as defined in the Social Security Act.

**BENEFIT.** The trust must be for the benefit of the individual with disabilities.

**ESTABLISHMENT.** The trust must be established by a parent, grandparent, guardian or the court.

**PAYBACK.** The state Medicaid agency must be reimbursed upon the death of the person with disabilities.

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

## WHAT PUBLIC BENEFITS ARE PROTECTED BY THE TRUST?

The purpose of a Special Needs Trust is to preserve public benefits programs for the person with disabilities. Typically these benefits include:

**SSI.** A monthly income.

**MEDICAID.** A medical payment program.

**SECTION 8 HOUSING.** A low-income housing program.

**STATE DISABILITY PROGRAMS.** These include group homes, vocational training, etc.

## 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 person with disabilities. Examples include personal effects such as furniture, appliances, computers, automobiles, rent, home improvements, pools, utilities, medical insurance, newspaper

subscriptions, 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. While these are non-countable assets, they are considered special assets. If the trust will be used to purchase these items, there are several options that must be considered in consultation with the special needs attorney 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 person with disabilities. Other family members or friends benefiting from the trust are usually required to pay a pro rata share for their benefit. Trust assets usually are not permitted to be used to discharge a parent's legal obligation of support.

### **HOW MUCH OF THE SETTLEMENT SHOULD BE STRUCTURED?**

Upon receiving a settlement, persons with disabilities and their families often want to purchase a new home and vehicle and take a dream vacation. They also may wish to pay off a certain amount of debt. A lump sum should be set aside for these items and to prepare for future emergencies. Only after those needs are met should the amount of the structure be determined. Structured settlements have significant advantages, including:

**TAX BENEFITS.** The income, including the investment income, is tax-free to the trust beneficiary.

**RATED AGE.** Many plaintiffs have a "rated age." This means that an insurance company believes that, as a result of injuries, the person with disabilities is much older physically than in actual age and therefore has a shorter life expectancy. In this case, an annuity can be purchased to pay for the lifetime of a much older person, thereby significantly increasing the monthly payment.

**PRESERVATION.** The average personal injury settlement, like the average lottery winning, lasts five years. By obtaining a structured settlement, a person with disabilities can receive a monthly income for life with a fixed period guaranteed even if he or she dies prematurely.

### **WHAT FEATURES SHOULD BE CONSIDERED IN A STRUCTURE?**

**COST OF LIVING.** Over time, cost-of-living increases reduce the purchasing power of a dollar. Structures can be designed to include a cost-of-living adjustment (COLA) feature. Because, historically, the cost of living has increased 3% a year, a structure with a 3% COLA, compounded, makes sense.

**POPs.** It usually is possible to anticipate that certain events will occur during the lifetime of the person with disabilities that will require lump sums of money. The structured settlement contract can be designed to take these into consideration. POPs establish that additional lump sums will be paid out at certain stages of the disabled person's life. For example, if the individual is likely to go to college, a significant lump sum could be paid to cover college tuition when he or she turns 18.

**COMMUTATION RIDER.** If a settlement is large, there may be federal and/or state estate tax due after the person with disabilities dies. A commutation rider in the structure ensures that monies will be available to pay these taxes, if necessary.

### **HOW IS THE TRUST ESTABLISHED AND FUNDED?**

Federal law requires that the trust be established by a parent, grandparent, guardian or the court. The trust cannot be established by the person with disabilities. 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 also must order that the monthly payments from the structure be paid by check directly to the trustee of the Self-Settled Special Needs Trust. Payments made to the personal injury attorney constitute "constructive receipt." This means that public benefit agencies will consider the money in the attorney's trust account to be available to the person with disabilities, disqualifying him or her from those benefits.

## HOW SHOULD THE MONEY BE INVESTED?

Any money placed in the Self-Settled Special Needs Trust, other than the structure, should be invested in accordance with the Uniform Prudent Investor Act. Because the assets need to last throughout the lifetime of the person with disabilities, they should be invested conservatively, with the objective of preserving principal while providing the growth necessary to outpace inflation and taxes. There should be a written Investment Policy Statement in place that specifies the acceptable level of investment risk to be taken and outlines the trust's investment strategy.

## HOW IS A TRUSTEE SELECTED?

Family members often want to serve as trustees of Special Needs Trusts. But, to ensure that the trust will be administered properly and continue to protect the public benefits of the person with disabilities, a trustee must have experience and expertise in the following areas, at a minimum:

**THE UNIFORM PRUDENT INVESTMENT ACT.**

**THE PRINCIPAL AND INCOME ACCOUNTING ACT.**

**PUBLIC BENEFITS LAWS.**

Since family members rarely have this expertise, a better solution is to select a professional trustee. Family members can remain involved by serving as co-trustees or trust protectors or by having a trust advisory committee appointed. The trust advisory committee, which can include a parent, a lawyer, an accountant, a social worker and even a sibling, advises the trustee with respect to distributions.

## WHAT CAN A COUNSELING SESSION ACCOMPLISH?

When establishing a Self-Settled Special Needs Trust, it is wise to have a counseling session with the special needs attorney, the person with disabilities, the trustee and other interested family members. The person with disabilities and/or family should prepare a budget. The family and the trustee should then agree on which budget items will be paid by the trustee, which by the disabled person, and which items, if any, can be purchased through use of a credit card that ultimately will be paid by the trustee.

It also is important to run a Monte Carlo Simulation, which provides a way to determine how long the trust will last assuming certain conditions, such as different levels of expenses and investment returns. Once it is understood that the trust should last the lifetime of the person with disabilities and a Monte Carlo Simulation has shown how long the trust is likely to last under various scenarios, the disabled person and/or family may agree to reduce expenditures to a more appropriate level.

Finally, the counseling session is an opportunity for the special needs attorney to review with the trustee, the family and the person with disabilities 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 should have been adopted that will enable the person with disabilities to receive maximum benefits from the trust during his or her lifetime.

## WHAT AGENCY APPROVALS ARE REQUIRED?

**SSA.** If the person with disabilities is receiving SSI, the Self-Settled Special Needs Trust should be filed with the Social Security Administration.

**MEDICAID.** If the person with disabilities is receiving Medicaid, the trust should be filed with the state Medicaid agency.

**FILING.** It is very important to file notices and copies of the trust document with the Social Security Administration and/or State Medicaid Agency. The special needs attorney generally is responsible for this. It also is important to submit a separate cover letter that shows SSA and the state Medicaid agency exactly how the trust document complies with their requirements. The agencies seldom respond with specific approval of the trust, but if they do not approve, they will respond with specific reasons.

## WHAT ESTATE PLANNING DOCUMENTS DOES THE PERSON WITH DISABILITIES NEED?

If the individual with disabilities is a competent adult and has such non-countable assets as a home, a vehicle or personal effects, he or she should consider executing a will. The individual also should execute an Advance Medical Directive/Living Will and a Durable Power of Attorney. Advance Medical Directives/ Living Wills are

important for anyone wishing to avoid a Terri Schiavo-type situation. A Durable Power of Attorney is extremely helpful in the event that an individual becomes incapacitated and is no longer able to take certain actions on his or her own behalf.

### **WHAT ESTATE PLANNING DOCUMENTS DO FAMILY MEMBERS NEED?**

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If the family members of an individual with disabilities intend to leave money to him or her – or for his or her benefit – they should execute a will, an Advance Medical Directive/Living Will, a Durable Power of Attorney and a Third-Party Special Needs Trust (sometimes called a Supplemental Needs Trust). Leaving money directly to a person with disabilities will jeopardize public benefits, while leaving it to a Self-Settled Special Needs Trust will trigger a Medicaid payback requirement. Placing the funds in a Third-Party Special Needs Trust can allow a family to supplement the lifestyle of the person with disabilities without loss of public benefits. Third-Party Special Needs Trusts operate in much the same way as Self-Settled Special Needs Trusts except that there is no Medicaid payback and no Medicaid accounting requirements.

Families that wish to establish Third-Party Special Needs Trusts should consult with a special needs attorney. It also is important that the family's beneficiary designations be reviewed to ensure that the Third-Party Special Needs Trust is the beneficiary of any funds intended for the individual with disabilities.

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**THOMAS D. BEGLEY, JR.** is a member of the Begley Law Group, P.C., with offices in Moorestown, Stone Harbor, Princeton, NJ and Huntingdon Valley, PA, where he concentrates in *Elder & Disabilities Law and Estate Planning*.

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**Publications:** He is co-author of the *Special Needs Trust Handbook* published by Aspen Publishing Company; he is a co-author of *Representing the Elderly Client*, Aspen Publishing Company; co-author of *Representing the Elderly or Disabled Client; Forms and Checklists with Commentary*, Warren, Gorham & Lamont; coauthor of *Profitable Law Firm Management*, New Jersey ICLE; the author of *How to Develop and Manage a Successful Trust and Estate/ElderLaw Practice*, New Jersey ICLE; he is a member of the Editorial Board of *Estate Planning Magazine*; contributing author of *New Jersey Elder Law Practice*, New Jersey ICLE; and contributing author *The Elder Law Portfolio Series*, Aspen Publishing Company.

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