Marquette Elder's Advisor

Volume 1
Issue 1 *Summer*

Article 13

Summer August 2012

The Use of Special Needs Trusts in the Settlement of Personal Injury Cases

Roger M. Bernstein

Margrit S. Bernstein

Follow this and additional works at: https://scholarship.law.marquette.edu/elders

Part of the Elder Law Commons

Repository Citation

Bernstein, Roger M. and Bernstein, Margrit S. (2012) "The Use of Special Needs Trusts in the Settlement of Personal Injury Cases," *Marquette Elder's Advisor*: Vol. 1: Iss. 1, Article 13.
Available at: https://scholarship.law.marquette.edu/elders/vol1/iss1/13

This Featured Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Elder's Advisor by an authorized editor of Marquette Law Scholarly Commons. For more information, please contact elana.olson@marquette.edu.

The Use of Special Needs Trusts in the Settlement of Personal Injury Cases

This article explores the ins and outs of special needs trusts, which can offer your clients improved protection against the loss of public benefits. These narrowly defined, specific trusts can help to avoid disqualification from Medicaid.

By Roger M. Bernstein and Margrit S. Bernstein

With the advent of amended 42 U.S.C. Section 1396p, effective with the Omnibus Budget and Reconciliation Act of 1993 (OBRA '93), the statutory *special needs trust*—sometimes called a *supplemental care trust* or *qualified disability trust*—has become the preferred method of settling personal injury cases for plaintiffs on Medicaid. If properly drafted, in addition to its obvious benefit of preserving actual or potential public benefits for the beneficiary, the special needs trust can also provide professional management and investment of assets for a disabled person, without the formal court supervision required in a property guardianship.

A special needs trust is an irrevocable trust established for the sole benefit of a disabled person. It is established with the assets of that person. It is often funded with the proceeds of a personal injury tort, medical malpractice claim, or a workers' compensation claim.

Trusts for Disabled Persons After OBRA '93: The Statute

The Statute, 42 U.S.C. Section 1396p(d)

OBRA '93 generally disqualifies Medicaid applicants who create trusts, or for whom trusts are created using the applicant's assets, after August 10, 1993. The statute provides a *safe harbor,* however, in the use of *trusts for disabled persons.* These protected trusts are exempt from the current attribution rules that apply to trusts created with the assets of an applicant/recipient of public benefits; they are also exempt from the transfer of asset restrictions that apply to transfers to trusts. There are only two types of trusts for disabled persons sanctioned by the statute at 42 U.S.C. Section 1396p(d)(4):

The "A" Trust

> (A) A trust containing the assets of an individual under age 65 who is disabled (as defined in section 1614(a)(3)) and which is established for the benefit of such individual by a parent, grandparent, legal guardian of the individual, or a court if the State will receive all amounts remaining in the trust upon the

Roger M. Bernstein, Esq., and *Margrit S. Bernstein, Esq.,* practice law as The Bernstein Law Office, P.A., in Coral Gables and Key West, FL. Their practice focuses on the areas of planning for personal injury settlements and for aging, illness, and incapacity. This article appeared, in a different form, in the *NAELA Quarterly,* Summer 1994.

> death of such individual up to an amount equal to the total medical assistance paid on behalf of the individual under a state plan under this title.

The "A" trust is most commonly used in the settlement of personal injury actions.

The "C" Trust

> (C) A trust containing the assets of an individual who is disabled (as defined in section 1614(a)(3)) that meets the following conditions:
>
> The trust is established and managed by a non-profit association.
>
> A separate account is maintained for each beneficiary of the trust, but for purposes of investment and management of funds, the trust pools these accounts.
>
> Accounts in the trust are established solely for the benefit of individuals who are disabled (as defined in section 1614(a)(3)) by the parent, grandparent, or legal guardian of such individuals, by such individuals, or by a court.
>
> To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the State from such remaining amounts in the account an amount equal to the total amount of medical assistance paid on behalf of the beneficiary under the State plan under this title.

The "C" trust is available in about 20 states and is appropriate for beneficiaries over age 65, for small settlements, and for those desiring a charitable remainderman trust.

Other Important Provisions of 42 U.S.C. Section 1396p

The Need for Disability

Both the "A" and "C" trusts refer to the assets of an individual who is "disabled" as defined in section 1614(a)(3) [42 U.S.C. § 1382(c)(a)(3)] which reads

> (A) An individual shall be considered to be disabled for purposes of this title [42 U.S.C. § § 1381 et seq.] if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months (or, in the case of a child under the age of 18, if that individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months).
>
> (B) For purposes of subparagraph (A), an individual shall be determined to be under a disability only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and work experience, engage in any other kind of substantial gainful work which exists in the national economy, regardless of whether such work exists in the immediate area in which he lives. . . .

The statute does *not* require that there be an actual finding of disability, nor does it require that the individual be receiving any kind of disability benefits.

The Age of the Individual

The "A" trust requires that the trust beneficiary be under age 65 when the trust is established. The statute itself is silent on whether a trust established for a disabled individual under the age of 65 must be terminated when the individual becomes 65. Medicaid has taken the position that if a trust is established for a disabled individual under age 65, the trust maintains its exempt status for the rest of the individual's life with respect to assets funding the trust prior to age 65.

Who Can Establish the Trust?

Only a parent of the individual, grandparent, legal guardian of the individual, or a court can establish an "A" trust. Note that the *individual* cannot establish his or her own "A" trust. (Some states have ignored this in their regulations.)

An individual account in a "C" trust established and managed by a nonprofit association can be established by the parent, grandparent, legal guardian of the individual, or *by such individual.* Nevertheless, the inability of a mentally competent disabled individual to establish an "A" trust is a serious problem.

If the individual has no parent or grandparent to act as settlor of the trust, he must seek access to a court for the appointment of a legal guardian or conservator or ask the court to serve as settlor.

Assets Held in a Guardianship Account Compared to Assets Held in a Special Needs Trust

Assets held in a guardianship (or in a revocable trust) *belong* to the ward and are thus, by definition, "available" to the ward for purposes of benefit eligibility determinations.[1] Assets held in an *irrevocable* trust belong to the trust and should not be counted as being available to the trust beneficiary, so long as the beneficiary has no ownership interest in and is not entitled to demand payments from the trust, and so long as the trust is drafted to conform to the form requirements of OBRA '93. With the passage of OBRA '93, the "nonavailability" of trust assets has been established as a body of federal law.

Providing Notice of the Establishment of a Trust for a Disabled Person

There is no requirement in the federal statutes that notice of the establishment of the "A" or "C" trust be given to any public agency. Nevertheless, if the client is receiving public benefits when the personal injury case is settled, and the trust will be established by the legal guardian or by the court itself, the practitioner should serve notice of the hearing to establish the trust on any public agency that has provided or is providing benefits to the individual or that might provide benefits in the future. The form and timing of the notice will be governed by local court rules.

If the trust is being established by a parent or grandparent without a court proceeding, notice should still be given to the public agencies. Notice should be given by certified mail, with a copy of the proposed trust and allowing a reasonable time period for the agency to respond before the trust is funded.

The federal statute that creates the "A" trust provides only that ". . . the State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance provided on behalf of individuals under a state plan under this title." The trust should include a provision that the trustee will notify the state Medicaid office of the death of the beneficiary, if Medicaid assistance has been provided. Furthermore, the trustee should ask Medicaid to submit its claim for reimbursement in writing.

Since the "C" trust legislation contemplates that the nonprofit association that manages the master trust will receive any balance remaining after the death of the beneficiary, there should be no affirmative obligation to notify Medicaid of the death of the beneficiary.

The Structured Settlement in a Personal Injury Context

A structured settlement is a way of resolving a personal injury claim in which a portion of the plaintiff's recovery is paid out on an installment basis in periodic payments, rather than in a lump sum.

Structured settlements enjoy income tax advantages. Generally, the amount of any damages received on account of personal injury or sickness are not included as income under the provisions of Internal Revenue Code Section 104(a)(2). The income earned by a lump-sum settlement, whether through interest, dividends, or capital gain, is *not* exempt from income taxation. However, the imputed income earned within a structured settlement is exempt from income taxation under Internal Revenue Code Section 130. A structured settlement allows a settling plaintiff and those claiming through the plaintiff to enjoy the benefit of this income tax exclusion.

Compared to a lump-sum cash settlement, the structured settlement is viewed by its proponents as an internally elegant package. It provides financial security in the form of a lifetime income, and it matches benefits with the plaintiff's needs. In addition, it provides management of the benefits, a guaranteed payment, and favorable income tax treatment.

The structured settlement periodic payment, however, does not eliminate the need for a supplemental care trust. Just as with a lump-sum payment, the monthly payment to the plaintiff will be counted as an available resource to the applicant for Medicaid and other public benefits. Many cases exist in which the cash portion of the settlement has been spent on the medical, custodial, and life care needs of the plaintiff, leaving only the income from the periodic payment. The periodic payment itself is not enough to meet the plaintiff's financial needs; yet its existence may be enough to disqualify the plaintiff from public benefits.

Practitioners have begun to use the supplemental care trust as a vehicle to hold the periodic payment. (A structured settlement payment standing alone will not meet the statutory requirements of the exceptions provided for in 42 U.S.C. Section

1396p(d)(4) since it is not a trust and since neither the state nor a charitable organization is the ultimate remainder beneficiary of the periodic payment to the extent of postsettlement Medicaid payments.)

A supplemental care trust drafted to comply with the applicable exceptions could be the payee of the structured settlement payment and should preserve all of the structured settlement benefits while preserving the plaintiff's eligibility for Medicaid.

Repaying the State for Medical Assistance After Death

The repayment obligation attaches to "amounts remaining in the trust." There is no requirement that the trust have *any* assets remaining upon the death of the beneficiary. The trustee can manage and deploy the assets for the beneficiary to exhaust trust assets during his lifetime, so long as the funds are expended for the "sole benefit" of the beneficiary.

If death is imminent, the trustee can prepay funeral arrangements if this has not been done upon the establishment of the trust. The trustee should prepay or reserve funds for administration expenses and taxes.

The "A" trust *must* contain a direction to first reimburse the state to the extent of medical assistance paid out on behalf of the beneficiary during the administration of the trust. New York State allowed the subordination of the entire pretrust Medicaid lien. The lien merged with the posttrust lien to be paid by the trust after the beneficiary's death. This position, consistent with the plain meaning of the statute, has been abrogated by New York in two companion cases.[2]

The repayment language can be drafted to anticipate the possibility that the reimbursement requirement may not be in the law when the beneficiary dies. But one should not be too creative in trying to deprive the state of its legislative claim for reimbursement.

The "A" trust should specify an ultimate residuary beneficiary for assets remaining in the trust after reimbursement of the state. It is possible to use a special power of appointment with a default provision. In drafting the residuary beneficiary provisions, consider that the selection of a beneficiary, while entirely proper under state law, can cause an otherwise irrevocable trust to be deemed a revocable trust for Social Security and Supplemental Security Income (SSI) purposes.[3]

Other Considerations in Drafting and Using the "A" and "C" Trusts

These trusts should not be used to hold other assets belonging to the disabled person or other assets that might be received, such as bequests from the parents or life insurance benefits. Once in the trust, these other assets will be subject to the claim for reimbursement for medical benefits at the death of the beneficiary. Consider a separate trust for these assets, either *inter vivos* or testamentary.

In drafting the "A" trust, consideration should be given to whether the beneficiary will be in an institution or at home. "Special needs" should be defined with reference to the actual anticipated needs of the beneficiary. If at home, the distribution standard should require the trustee to respect the SSI rules relating to in-kind distributions and payments for food, clothing, and shelter.

Finally, a provision should be included in the irrevocable trust to permit the trustee to amend the trust solely for the purpose of conforming the trust to the changing requirements of 42 U.S.C. Section 1396 and state regulations.

As more experience is gained in the administration of special needs trusts a body of law and practice will develop to aid the disabled community and its advocates.

Endnotes

1. See *Frerks v. Shalala,* 52 F.3d 412 (2d Cir. 1995).
2. *Cricchio v. Pennisi* and *Link v. Town of Smithtown,* 1997 NY Lexis 310 (N.Y. Ct. App., March 25, 1997).
3. The applicable provisions are in the Social Security Administration's Regional Program Operation Manual System (POMS) at SI R01120.200. The ten Social Security regions do not follow the same rules.