RISK MANAGEMENT RESOURCES

ARTICLES

Best Of Both Worlds: Using Special Needs Trusts And Structures To Preserve Your Injured Victim's Settlement Recovery

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Best Of Both Worlds: Using Special Needs Trusts And Structures To Preserve Your Injured Victim's Settlement Recovery

Obtaining a favorable settlement or judgment for a physically injured client is difficult enough in ordinary circumstances. If the client is disabled and receives needs-based public benefits, however, designing the award in a manner that those benefits will not be eliminated or reduced becomes an additional challenge. The self-settled special needs trust is a valuable tool for planning in this context. This article describes the use and operation of a self-settled special needs trust, details how an award payable to a self-settled special needs trust can be divided into lump-sum and structured settlement portions to best accommodate the disabled client's unique circumstances and needs, and explains the recent resolution of a potential issue related to the use of future payment streams from a structured settlement in the self-settled special needs trust context.

THE USE AND OPERATION OF A SELF-SETTLED SPECIAL NEEDS TRUST

Many disabled clients depend on needs-based, or public benefits for the basic essentials of life. Medicaid and SSI are two of the most important needs-based programs. Medicaid provides health care services to disabled individuals with income and assets below certain threshold levels. SSI provides cash payments for housing and food costs to disabled individuals who meet similar qualification standards.

If a Medicaid and SSI recipient receives an outright lump-sum award, that individual likely will become ineligible for public benefits because his or her assets will usually exceed the eligibility threshold. Although eligibility will be restored once the award is spent down, no funds will remain for future unmet needs to enhance the disabled client's quality of life, such as transportation costs, special medical devices and treatment, attendant care, educational and recreational expenses and other personal living expenses.

If the settlement is set up so that future periodic payments are made directly to the disabled client using a qualified structured settlement annuity, the payments – although paid free of federal and state income tax -- will be construed as income for eligibility purposes and probably will have the same disqualifying effect as a lump-sum settlement. Given that many structured settlements are designed so that the claimant receives payments for life, restoration of public benefits might never occur, leaving the client in a sort of no-man's land with no public benefits but insufficient means for self-support.

In this context, a self-settled special needs trust can be a solution. Under federal law, a disabled individual's assets can be transferred into this type of trust without penalty, and the trust assets will not be considered for purposes of Medicaid or SSI eligibility. The trust then can make expenditures for the benefit of the disabled beneficiary to cover expenses not otherwise met by public benefits.

To qualify as a self-settled special needs trust, the trust must have the following features:
- The trust must be irrevocable;
- It must be established for the sole benefit of a disabled individual;
- It must be funded with the disabled individual's assets. Tort recoveries are considered assets of the indi-

vidual;
- It must be established and funded before the disabled individual reaches 65 years of age;
- It must be established by a court, the disabled individual's guardian, or the disabled individual's parent or grandparent; and
- To the extent that trust assets remain after the disabled individual dies and the trust terminates, the trust must repay the state Medicaid agency for amounts expended on the disabled individual's behalf. (This pay-back requirement is a significant distinction from a third-party special needs trust, which can be established with the assets of another for the benefit of a disabled individual but does not require pay-back.) Any trust assets remaining after the state Medicaid agency has been re-paid may then be distributed to the decedent's designated beneficiaries.

PLANNING THE SETTLEMENT

If the self-settled special needs trust is determined to be an appropriate option for receiving a disabled client's settlement recovery – in whole or in part (with remaining settlements coming from a structured annuity), the settlement recovery still must be planned properly to accommodate the disabled individual's unique needs and circumstances. Often, it is advantageous to "seed" the trust with an initial lump-sum amount and structure the remainder of the award.

The lump-sum amount can be useful in addressing immediate needs, such as purchasing a handicap accessible van, wheelchair, or medical equipment or purchasing or making renovations to the injured victim's home. The lump-sum also can provide a reserve for future needs that are not initially anticipated. Thus, the claimant has a degree of immediately available liquidity for such needs which would not otherwise be afforded by a structured settlement alone.

The future periodic payments of the structured settlement portion can then ensure a guaranteed, tax-free income stream to cover recurring anticipated expenses, such as attendant care, utility, telephone and cable bills, physical therapy, and educational expenses, among others. The guaranteed nature of the structure payments protects against the injured victim against market fluctuations and volatility that otherwise might jeopardize the disabled individual's care and maintenance through other financial instruments bearing more risk, or dissipation of the trust corpus.

Moreover, for seriously injured personal injury claimants who must have a lifetime of guaranteed payments, the qualified structured settlement annuity has the ability to take into account substandard age ratings, based on an actuarially-adjusted decreased life expectancy determined by skilled medical underwriters. The benefit of obtaining such "rated ages" is that the life contingent, structured settlement annuity will likely boost the future periodic payment stream significantly, and provide greater rates of return than financial instruments in which the trust might otherwise invest. Moreover, the returns of a substandard age-rated, structured settlement annuity will be paid into the trust tax-free, and at greater rates of return than those offered by a traditional, single premium annuity, which is not paid tax-free and from which the claimant is ineligible for substandard ratings and better benefit levels.

When using both an initially-seeded, self-settled special needs trust and the future periodic payments from a qualified structured settlement, it is imperative that all such payments from the settlement recovery be made directly to the self-settled special needs trust. Payments filtered through the disabled beneficiary (or his/her attorney's trust account) to the trust can result in the reduction or elimination of public benefits to which the claimant is otherwise entitled.

THE RESOLUTION OF A POTENTIAL PROBLEM RELATED TO THE USE OF STRUCTURES IN THE SELF-SETTLED SPECIAL NEEDS TRUST CONTEXT

As indicated above, one qualifying aspect of a self-settled special needs trust is that it must be established and funded prior to the disabled individual reaching age 65. This general rule would appear problematic given that the structured portion of a settlement typically established, as discussed above, for life using a rated age.

If a structure payment to a self-settled special needs trust after age 65 would violate the rules for having the payment or trust excluded for public benefits purposes, then a distinct advantage of the structure - the guarantee of a lifetime income stream for anticipated needs that the trust beneficiary cannot outlive - would be completely undermined. From a policy perspective, this would be a poor result, as the individual's needs simply do not cease at an arbitrary future age, such as age 65. This outcome would limit the use of structures in special needs planning and encourage funding self-settled special needs trusts entirely with lump-sum amounts only - a plan that could have disastrous consequences to the trust beneficiary if the trustee cannot guess accurately the beneficiary's lifespan and budget accordingly. Moreover, the significant risk of market volatility could seriously dissipate the trust's assets, such that those assets are not available for the life of the injury victim.

The Social Security Administration issued recent guidance clarifying its position on this issue. Under that guidance, if the right to receive structure payments was irrevocably assigned to a self-settled special needs trust prior to the disabled trust beneficiary reaching age 65, then the future structured settlement payments after age 65 are treated the same as payments made to the trust prior to age 65, and do not disqualify the trust from the special needs exception. Therefore, for SSI purposes, structures payable to a self-settled special needs trust are confirmed as a viable option.

The issue, however, remained unsettled for Medicaid qualification purposes. In fact, the section of the most recent North Carolina DHHS Medicaid Manual that governs the treatment of structure payments to a self-settled special needs trust indicated that any additions to a trust after age 65 would be assessed as a transfer, and thus could disqualify the trust beneficiary from public benefits.

Based upon inquiry and explanation of the underlying issues, the Division of Medical Assistance at North Carolina DHHS recently reconsidered this position and agreed that structured settlement payments to a self-settled special needs trust after the beneficiary reaches age 65 do not violate the special needs trust exception provided that the structure payments were irrevocably assigned to the trust prior to the beneficiary reaching age 65. They have indicated a change will be made to the next version of the Medicaid Manual to clarify this issue and have already instructed DSS field staff regarding this matter.

CONCLUSION

The self-settled special needs trust is a powerful tool for the disabled client who is entitled to a monetary award for his or her physical injuries. Through careful planning, the settlement of a personal injury claim based on physical injuries to the victim can be designed to pay to the trust in a manner that preserves public benefits and accommodates the client's actual needs and circumstances -- possibly for a lifetime. Based on guidance from SSA and, most recently, by the NC DHHS, qualified structured settlement annuities can be an integral part of that overall plan. The primary benefit of using both the self-settled special needs trust and a structure are that (1) the trust assets remain available and liquid to the trust beneficiary for on-going and/or emergent life care needs and (2) the trust assets are not depleted, or completely dissipated, because of the guaranteed future periodic payments provided by a life contingent structured settlement.

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