Special Needs Trusts in the Context of Personal Injury Settlements

I. INTRODUCTION

Virtually any personal injury case will involve two issues that are often seen as afterthoughts by personal injury attorneys, but which can be vital to the success of any case from the point of view of the client: satisfaction of liens against the settlement and structuring the settlement to best meet the client's circumstances and needs. The second issue involves both the preservation of public benefits and management of settlement proceeds for clients who cannot or should not manage funds on their own.

II. LIENS

While private insurers and health care providers often have contractual and statutory claims to be reimbursed for the expenses of caring for a tort plaintiff, the most significant lienholders for disabled clients and their attorneys are Medicaid and Medicare liens. Not only are these government programs most likely to be the insurers, but they have statutory claims that impose liability on the personal injury attorney if their liens are not met.

A. Medicaid

Medicaid is a state and federally administered program that provides health benefits to a recipient. When payments are made to cover medical care for a beneficiary for injuries resulting from someone's negligence, the state agency automatically has a lien against any money recovered in any claim asserted as a result of that accident.

Notice requirements for Medicaid liens are often much more vague than notice requirements for other types of insurance. While a statute may state that a lien is perfected after notice to the third party, notice is not defined. It is unclear if it must be in writing and sent by the department or if it can be oral or even constructive. In ___________, for instance, a Medicaid beneficiary is compelled by statute to complete an "Assignment" form assigning whatever is recovered to the state, up to what is owed, when he or she applies for benefits. This form states that if the assistance is due to an accident the claimant must repay the agency for any benefits received. In practice, this "Assignment" functions as notice. In addition to the obligation to complete the "Assignment," the claimant must notify the agency within ten days of the commencement of a civil action to establish liability of a third party. Again, each state is likely to vary in their notice practices, thus an attorney should identify their responsibilities for their particular state.

In practice, the Medicaid agency generally agrees to share in attorney's fees if it is contacted prior to settlement. In seeking a reduction, the plaintiff's lawyer will be asked to complete a form detailing information about the case, including the proposed amount of the settlement, any remaining unpaid medical expenses, and whether the attorney is willing to reduce his fees. Reduction negotiations should begin before the actual settlement of the third party claim is reached. Otherwise, the Medicaid agency will have no incentive to reduce its claim since it has a statutory right to its entire claim.

The Medicaid lien is only for benefits resulting from the injury for which the beneficiary receives recovery. It is possible, but difficult, to argue that a portion of the recovery is for other injuries for which the beneficiary did not receive Medicaid benefits. A more successful argument can often be made, where there are multiple plaintiffs, that a portion of the settlement amount should be attributed to plaintiffs who did not receive Medicaid benefits. Finally, it is important to review the Medicaid claim carefully to make sure that it is submitting a claim only for benefits paid as a result of the injury that gave rise to the personal injury action.

Litigants in a number of states have argued that under 42 U.S.C. §1369p(d)(4)(A) they should be permitted to fund a “(d)(4)(A)” trust prior to paying off any Medicaid lien. Despite some early success, this line of case has ultimately been unsuccessful.

B. Medicare

Medicare is the federal health insurance program administered by the Centers for Medicare and Medicaid Services (“CMS”) formerly known as Health Care Financing Administration for Social Security beneficiaries, either retirees or disabled workers. Medicare’s right to reimbursement is contained in 42 U.S.C. §1395y(b)(2)(A), (B) and the regulations interpreting the statute are at 42 C.F.R. §§411.20-411.54. These rules are somewhat contradictory. First, Medicare is prohibited from paying medical bills when Medicare is a “secondary payer,” meaning that there is some other “primary” insurer to pay the bills. A primary insurer is essentially any insurance company that either is or will pay for the medical bills in question, thus making Medicare a secondary payer. Second, Medicare may, however, pay for such bills even if there is a primary payer but in that case, the payments are automatically conditioned on Medicare being reimbursed no later than 60 days following the receipt of any kind of settlement or judgment proceeds. If the payments are not reimbursed in those 60 days, interest may be assessed. Additionally, if Medicare is not reimbursed within 60 days, it may seek reimbursement from “any entity that has received a third party settlement.” This includes attorneys.

Medicare’s right of reimbursement arises when it pays a medical bill and there is existing notice that a primary insurer exists which has paid or can reasonably be expected to pay the same bill. The existence of such a primary insurer is obvious in third party litigations since there would not be litigation if the primary insurer did not exist. Thus, there is essentially no notice requirement. In practice, Medicare often sends written notice of its right to reimbursement to all parties in the litigation process.

Unlike the Medicaid lien, CMS does share attorney’s fees and other costs. Pursuant to 42 C.F.R. §411.37, Medicare must reduce, on a pro rata basis, the amount it seeks to be reimbursed. The reduction percentage is the same percentage as the “procurement costs” in the case, meaning the percentage of the recovery going to the lawyer for his or her fees and costs.

C. Insurers and Medical Providers

Depending on state law, ERISA, and health insurance contracts, private health care providers and insurers may also have subrogation rights to a share of personal injury awards. Unlike Medicaid and Medicare’s right to assert a lien, insurer’s rights to assert a lien are often based on contract and attorneys are generally not liable for their payment.

III. SETTLEMENT CONSIDERATIONS

The first rule of thumb is that any Medicaid or Medicare lien must be settled along with the underlying case. All too often, they are regarded as afterthoughts. Second, even at the outset of a case, attorneys must consider who all the plaintiffs are. This can be important both for avoiding or minimizing claims against the recovery and for funding the best possible trust for the client. In addition, for large cases, distributing the settlement proceeds among several plaintiffs can limit estate tax consequences down the line.

It is often the case that a spouse or child(ren) will have claims for negligent infliction of emotional distress or loss of consortium. In a settlement, the defendant or defendants don’t care too much how the money is distributed among all claimants. However, in order to escape successful challenge by a lienholder, the distribution of the funds must bear some defensible relation to the injury suffered by each plaintiff. The attorney must ask questions about the relationship between a tort victim and close relatives if she is going to argue for large loss of consortium or emotional distress damages. To avoid potential allocation conflicts, an attorney should seek assent of the lienholder, subrogated insurer, or assigner before a final settlement is agreed upon.

IV. PUBLIC BENEFITS PROGRAMS

The personal injury plaintiff may be receiving benefits from any number of public benefits programs whether as a result of the injury or prior to its occurrence. The principal health care programs are Medicaid and Medicare and the principal income support programs are Supplemental Security Income (SSI) and Social Security Disability Income (SSDI). But plaintiffs may also receive Aid to Familes with Dependent Children (AFDC), food stamps or subsidized housing benefits. Every program has its own eligibility rules and the receipt of a settlement may mean the loss of benefits, depending on the program. If this means the loss of housing, a medical provider, or a structured work program, the plaintiff may be better off not recovering anything. However, in most cases the settlement can be structured to preserve the benefits. Each program has its own rules regarding transfers of assets and trusts. The rules of the major programs are described below.

A. Medicaid

Under the Medicaid program, in general, the funds in a trust created by an applicant for Medicaid or by his or her spouse (or by someone else using the applicant or spouse’s funds) will be considered available to the applicant to the extent the trustee has discretion to make payment to the applicant or on his or her behalf. With respect to trusts created by someone other than the applicant (or spouse) but to benefit the Medicaid applicant, the funds will be considered available only to the extent the trustee has an obligation to make payment to or on behalf of the Medicaid applicant or beneficiary. If the trust is discretionary, the funds will be considered available only to the extent the trustee chooses to make them available by distributing funds to the applicant or by paying for food, clothing, or shelter on his or her behalf.

Congress has carved out two safe harbors of special interest to tort victims: the “(d)(4)(A)” or “Payback” trust and the “(d)(4)(C)” or “Pooled” trust. Assets in these trusts are not considered countable assets in determining an applicant’s eligibility.

The corpus and income of a Payback trust will be treated under the same rules as a third-party trust as long as it meets the following requirements set out in 42 U.S.C. §1396p(d)(4)(C):

1. The trust was created for a disabled individual under the age of 65.
2. The trust was created for the sole benefit of the individual by the individual’s parent, grandparent, legal guardian, or court.
3. The trust provides that state Medicaid agency will receive amounts remaining in the account upon the death of the individual up to the amount paid under the Medicaid program for services to the individual.

A Pooled trust will also be treated as a third-party trust as long as it meets the following requirements set out in 42 U.S.C. §1396p(d)(4)(C):

1. The trust was created by a nonprofit organization.
2. A separate account is maintained for each beneficiary of the trust, but the assets of the trust are pooled for investment and management purposes.
3. The account in a Pooled trust was created for the sole benefit of the individual’s parent, grandparent, a legal guardian, a court acting on behalf of the individual, or the individual himself or herself.
4. The trust provides that to the extent trust funds do not remain in the trust upon the death of the beneficiary, the state Medicaid agency must receive amounts remaining in the account upon the death

of the individual up to the amount paid under the Medicaid program for services to the individual.

5. The individual was disabled at the time his or her account in the Pooled trust was created.

The Payback and Pooled trusts are similar, but have significant differences. First, the Payback trust is an individual trust while the Pooled trust is an account within a larger trust run by a nonprofit organization. Second, the beneficiary of the Payback trust must be under age 65 when it is set up (though the safe harbor continues after he or she passes that threshold), while the Pooled trust account can be set up at any age. Third, the beneficiary himself or herself cannot set up a Payback trust (this is reputed to be scrivener's error on the part of Congress, but it has never been corrected); it must be created by a parent, grandparent, guardian, or court. The Pooled trust account can be created by these people or entities, or by the beneficiary himself or herself. Finally, with the Payback trust, the requirement that the state Medicaid agency (or agencies) be paid back at the beneficiary's death is sacrosanct. With the Pooled trust, the person setting up the account has the option of directing that some or all of the funds remain in the trust for the benefit of other disabled individuals. (Check to see how your state is interpreting this rule. While some states are overreaching by not leaving this decision to the person setting up the account, it's hard to fight a state agency on this.)

B. Supplemental Security Income (SSI)

Supplemental Security Income (SSI) provides a minimum level of income for people 65 years of age or older, or who are blind or disabled. Financial eligibility for the program rests upon both income and resources requirements. With the exception of retroactive SSI payments and retroactive Social Security Disability Insurance, lump sums received by a beneficiary, whether from a tort settlement or another source, are considered income in the month received and resources if the beneficiary's assets still exceed $2,000 in the subsequent calendar month. Prior to December 1999, SSI beneficiaries could freely transfer resources to get below the $2,000 threshold and fund trusts for their own benefit. If the trusts were irrevocable they would be treated like third party trusts with the funds being counted as available to the beneficiary only to the extent the trustee (1) is obligated to make distributions to the beneficiary, (2) makes distributions directly to the SSI beneficiary, or (3) pays for "necessities"—food, clothing, or shelter. These rules still apply to trusts created and funded before January 1, 2000.

In December 1999, as part of the Foster Care Independence Act, Congress adopted the Medicaid transfer and trust rules for SSI. The new rules apply to trusts established on or after January 1, 2000, and to transfers made on or after December 14, 1999, the date the Act was signed into law. Under the new rules, property of self-settled trusts will be considered available to the beneficiary for purposes of determining eligibility for SSI unless it falls into the Payback or Pooled trust safe harbors.

V. PRESERVING BENEFITS

Once a settlement or judgment is reached in the personal injury case, the attorney and recipient must evaluate whether to have the funds distributed outright to a plaintiff or to use a structured settlement or a supplemental needs trust, or a combination of both. The attorney must consider: (1) whether the client might benefit from available public benefits programs now or in the future; (2) whether the client can manage responsibly a large amount of funds; (3) creditor protection; (4) investment strategy; and (5) protection against liens and estate claims by state agencies.

The four strategies that exist for managing the settlement or judgment are spending the award, giving it away, transferring it into a trust that is in compliance with public benefit rules, and allocating the award to other plaintiffs.

A. Spending the Settlement
While most public benefits programs count assets, a personal injury award can be preserved by spending it on noncountable assets. All public benefits programs that have an asset eligibility limit have a list of exclusionary assets exempt from counting. These assets frequently include a home of any value, a prepaid irrevocable funeral contract, clothing, household goods, and a car. If a personal injury recipient wishes to choose the spend-down option, the list of noncountable assets should be studied in advance so that expenditures can be planned and executed quickly.

B. Giving Away Assets
Prior to the imposition of the new SSI transfer rules at the beginning of 2000, SSI recipients often gave away personal injury settlement funds in order to maintain their eligibility for benefits. They might expect family members to hold the funds as an informal trust. This could work, but might not. Common problems include the expenditure of the settlement by the transferee for their benefit, the division of the settlement with the transferee's spouse in cases of divorce, the loss of the settlement to the transferee's heirs if the transferee dies before the disabled person, or to estate taxes on the transferee's estate.

With the new SSI rules, there is a debate about whether transfers may still be made if this is done during the month that the settlement funds are received. The SSI program has always distinguished between income and resources, treating settlements as income during the month of receipt and as resources the following calendar month. The new transfers rules only apply to resources. An argument can be made that the transfer penalties do not apply to transfers of income. So far, this has not been clarified by the Social Security Administration or any court.

C. Trusts
Transferring a settlement into a trust is often the most effective way to preserve the settlement and the victim's public benefits. The fact that a settlement has been transferred into a trust does not necessarily, however, protect the assets. The trust must be drafted in accordance with the specific rules of the public benefits program of which the person is a recipient. While each program has its own rules, there are certain rules common to all trusts:

- The trust must be irrevocable;
- The beneficiary cannot have the authority to make distributions, meaning they cannot be the trustee;
- The trust should not be for the benefit of the applicant.

The interplay of the Medicaid and SSI rules on transfers and eligibility, and the fact that the attorney often is dealing with eligibility for public benefits of both the grantor and the beneficiary, cause considerable confusion. The following list of the various trust options and their uses should be considered when dealing with a personal injury settlement or judgment:

1. Supplemental Needs Trusts
This is a third-party trust created by one person, usually a parent, for the benefit of a disabled person. The trust must be clearly discretionary in nature and not be a support trust. It must name a remainder beneficiary. The trust may be revocable or irrevocable.

2. Sole Benefit Trust
Also for the benefit of someone else, but used in situations where the grantor is seeking Medicaid eligibility for him or herself. The beneficiary must be under age 65. The trust must only be for the benefit of the disabled beneficiary. In many states, at the beneficiary's death the trust must be payable to his or her estate or to the state, to the extent of Medicaid payments on the beneficiary's behalf. This may make the trust countable with respect to the beneficiary's SSI benefits. This trust must be irrevocable.

3. Self-Settled Supplemental Needs Trust

Until January 1, 2000, an SSI beneficiary could create a supplemental needs trust for his or her own benefit without incurring a period of ineligibility. This is no longer true. However, an irrevocable, self-settled trust may be useful in some situations for clients receiving only specific benefits, such as subsidized housing.

4. “(d)(4)(A)” Trust

This is a self-settled trust under a “safe harbor” for purposes of Medicaid eligibility. It must be “created” by a court, guardian, parent, or grandparent and can provide discretionary income and principal to the recipient. The beneficiary must be under age 65 when the trust is created and funded. The trust must provide that the remaining trust funds at the individual’s death first be applied toward reimbursing the state for its Medicaid expenditures. Notably, only Medicaid will be reimbursed under a (d)(4)(A) trust. The trust need not provide for reimbursement of SSI. Thus, if there are no substantial Medicaid expenditures, the remaining trust funds may pass to whomever the client designates, just as before the new law.

5. “(d)(4)(C)” Trust

A (d)(4)(C) trust is a Pooled trust for disabled individuals that is established and managed by a nonprofit association. Separate accounts are managed for each beneficiary and the account may be established by the client or by a parent, grandparent, legal guardian, or court. In contrast to a (d)(4)(A) trust, funds remaining at the death of the beneficiary may stay in the Pooled trust for the benefit of other trust beneficiaries rather than being paid to the state. To the extent amounts remaining in the individual’s account at death are not retained by the trust, the trust must reimburse the state for all medical assistance paid. Although a (d)(4)(C) trust is an option for a disabled individual over age 65 who is receiving Medicaid, the new law only permits SSI recipients under age 65 to make transfers to the trust without incurring a transfer penalty.

D. Allocation

Allocation of settlement proceeds among multiple plaintiffs was discussed above as a means to defeat a Medicaid or Medicare lien. It can be even more important in terms of preserving public benefits for a client. Funds going to another plaintiff will not affect the injured party’s continuing or future eligibility for benefits. Trusts created by a third party for the benefit of the injured individual do not come under the same restrictive rules as those created with his or her own funds. Finally, in the case of large settlements, allocation of proceeds to secondary plaintiffs can have important tax planning benefits.

In allocating proceeds among multiple beneficiaries, the attorney must follow a rule of reason so that the allocation will not be challenged. But that can take into account the realities of the case. A loss of consortium claim by a parent of a severely injured young child will be much stronger than that of a parent of an older child who was not as severely injured.

VI. STRUCTURED SETTLEMENTS

Recognizing that clients often may not be the best at managing their own funds, attorneys have often encouraged them to “structure” their settlements so that they receive their funds in partial distributions over many years. A structured settlement can ensure a consistent and predictable stream of income to the injury victim for medical and living expenses. Structures also provide significant tax advantages because the payments are not taxed. Depending on the client’s income and tax bracket, the structure may provide a better fixed-income return than is otherwise available for most investors.

Structures are also often used as a means to bring the plaintiff to settlement. On one hand, the assured income may satisfy the plaintiff that he or she will receive sufficient funds to compensate for the injury over his or her life. On the other hand, the payout over several decades may be sufficiently impressive to satisfy the plaintiff that the settlement is large enough to compensate for the injury. In cases where the settlement is small and no professional trustee and no appropriate family member or friend is available to serve as a volunteer trustee, a structured settlement can provide an ideal management tool. Additionally, annuities are further ways of avoiding probate. Annuities may name a remainder beneficiary to continue to receive payments for a guaranteed number of years.

These are all arguments for using a structure. Several arguments may be made against structures, or at least against structures by themselves as a means to manage settlement proceeds. First, they can have a devastating effect on eligibility for public benefits. If public benefits are a concern, the annuity should be paid into a supplemental needs trust. Second, while structures compete well against other fixed-income investments, they will not participate in any stock market growth such as that experienced over the past decade. Any large settlement should be at least in part invested in equities. Third, structures do not provide funds for large capital purchases, such as a house, a medical expense that is not covered by insurance, or a wheelchair van. In most cases, it is important to have a significant fund available for unanticipated needs. Fourth, in the case of large structures, they can create estate tax problems if the beneficiary dies while there are still large sums to be paid out to heirs.

Another important issue an attorney should consider in regard to structured settlements is the possibility that a client may choose to sell a portion of the settlement to a “factoring company” for a fraction of what the settlement is worth. Selling a portion of a settlement is often attractive to injury victims because it provides a larger immediate payment, as compared to the monthly amounts received from the structure. Selling part of a structure, however, results in a loss of value of the settlement and can potentially reduce the monthly payments the injury victim receives.

Depending on the situation, the best solution may be a combination of a structure and a trust. It provides for the management and public benefits protections of a trust and the assured tax advantaged returns of a structured settlement.

VII. CHOOSING A TRUSTEE

In addition to complying with the specific requirements of each public benefits program, special consideration must be given to the selection of the trustee. Few legal restrictions exist for trustee selection. While some states may limit the ability of individuals or corporations to act as trustee without being licensed or registered by a bank or other appropriate agency, few other restrictions exist. The most obvious choices, along with some of the benefits and disadvantages of each, are listed below (Robert B. Fleming, Choosing a Trustee, Special Needs Trusts, Stetson College of Law, October 22, 1999):

1. Parents. Parents are good choices from an economic perspective, in that they usually don’t charge a fee, unlike a professional trustee. If the plaintiff is a minor, his parents will know his needs better than anyone else and will be able to plan for his future needs.

But whether particular parents are the best choice depends on a number of factors. While they are very familiar with the daily needs of the beneficiary, they may not be able to view the entire picture objectively. They frequently suffer conflicts of interest given that the decisions they must make as trustee could potentially have a large effect on the household and the parent/trustee’s decision may be influenced by that knowledge. The parent also may not have the necessary investment experience needed to manage the trust.

2. Other family members. Non-parent family members may be appropriate to serve as trustees. They may be better able to manage the business, tax, and administrative concerns of the trust. Additionally, the likelihood of self-dealing may be reduced. Family members are also economically advantageous, since they will likely charge less than a professional trustee. The reduced costs and security offered by a non-parent family member make them an attractive choice as trustee.

3. Family friends. A professional individual, a trusted advisor, or a close friend may serve as trustee. A close friend may be willing to serve as trustee for lower fees. Additionally, a close friend may be more accessible in emergency situations and more willing to take on the social worker aspects associated with the trust than would a professional trustee. However, before agreeing to a family friend, the attorney should do her best to make sure that the friend has sufficient experience and is sufficiently reliable to fill this important role.

4. Banks and trust companies. Historically, banks and trust companies were the most common choice for trustee. With a solid backing of experience, the family could reasonably expect that a given bank or trust company's investment policies would reflect the same balance of considerations in ten years as at present. Additionally, banks and trust companies offered continuity for the family.

The major drawbacks surrounding banks and trust companies as trustees are cost and inflexibility. In addition, they may be unequipped to take on the quasi-social work role often required in special needs cases. Often banks also are unfamiliar with the rules of public benefits programs and forego available benefits, to the detriment of the trust.

Finally, the recent merger of banks has meant for many trust beneficiaries that instead of dealing with their local banker who they know and trust, they must work with an unknown trust officer who they may only know over the telephone.

5. Attorneys. In recent years, an increasing number of attorneys have begun serving as trustees. Special needs trusts are particularly conducive to attorney trustees. The eligibility, investment, and special needs considerations have legal issues and the lawyer will likely be involved in the administration of the trust, regardless of whether he or she serves as a trustee.

There are, however, difficulties associated with choosing an attorney to serve as trustee. The attorney is not as close as family members or friends and is likely to be an expensive alternative. Additionally, the attorney may not have the necessary investment and accounting background or resources on staff. Finally, individual lawyers are not as permanent as a bank or other institutional trustee.

6. Other institutional/corporate trustees. Recently, professional fiduciary organizations have been popping up throughout the country. They may either be social service agencies, offshoots from public agencies who have trained their employees to act as fiduciary, or geriatric case managers who have trained their employee to act as trustee. Such organizations may be particularly suited to administer a special needs trust. They should, however, be viewed cautiously since little regulation exists for private fiduciary business.

In short, there is no perfect choice. When choosing a trustee, the factors to be considered include the cost of the available parties, relative investment experience, and flexibility and bureaucracy. Additionally, the trustee's knowledge of public benefits programs and their regulations, as well as the beneficiary's special needs and circumstances, should be considered. Often it can make sense to split the necessary trustee roles, with a bank or trust company handling investments and accounting, a family member or social worker taking care of planning for the beneficiary and disbursements, and an elder law attorney advising on public benefits issues. This can be done through multiple trustees, or a single trustee advised by individuals with the necessary knowledge and experience.